15-233

No.

IN THE

Supreme Court of the United States

THE COMMONWEALTH OF PUERTO RICO, ALEJANDRO GARCÍA PADILLA, as Governor of the Commonwealth of Puerto Rico, and CÉSAR MIRANDA RODRÍGUEZ, as Secretary of Justice of the Commonwealth of Puerto Rico,

Petitioners,

v.

FRANKLIN CALIFORNIA TAX-FREE TRUST, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITION FOR WRIT OF CERTIORARI

CÉSAR MIRANDA RODRÍGUEZ
Secretary of Justice
MARGARITA MERCADO ECHEGARAY
Solicitor General
DEPARTMENT OF JUSTICE
COMMONWEALTH OF PUERTO RICO
P.O. Box 9020192
San Juan, PR 00902

CHRISTOPHER LANDAU, P.C.
Counsel of Record
SUSAN M. DAVIES
CLAIRE MCCUSKER MURRAY
KIRKLAND & ELLIS LLP
655 Fifteenth St., N.W.
Washington, DC 20005
(202) 879-5000
clandau@kirkland.com

August 21, 2015

QUESTION PRESENTED

Whether Chapter 9 of the federal Bankruptcy Code, which does not apply to Puerto Rico, nonetheless preempts a Puerto Rico statute creating a mechanism for the Commonwealth's public utilities to restructure their debts.

PARTIES TO THE PROCEEDINGS BELOW

Petitioners, the Commonwealth of Puerto Rico, Alejandro García Padilla, as Governor of the Commonwealth of Puerto Rico, and César Miranda Rodríguez, as Secretary of Justice of the Commonwealth of Puerto Rico, were appellants in the First Circuit. In addition, Melba Acosta Febo and John Doe, as agents for the Government Development Bank of Puerto Rico, were appellants in the First Circuit.

Respondents, Franklin California Tax-Free Trust, Franklin New York Tax-Free Trust, Franklin Tax-Free Trust, Franklin Municipal Securities Trust, Franklin California Tax-Free Income Fund, Franklin New York Tax-Free Income Fund, Franklin Federal Tax-Free Income Fund, Oppenheimer Rochester Fund, Municipals Oppenheimer Municipal Fund, Oppenheimer Multi-State Municipal Trust, Oppenheimer Rochester Ohio Municipal Fund, Oppenheimer Rochester Arizona Municipal Fund, Oppenheimer Rochester Virginia Municipal Fund, Oppenheimer Rochester Maryland Municipal Fund, Oppenheimer Rochester Limited Term California Municipal Fund, Oppenheimer Rochester California Municipal Fund, Rochester Portfolio Series, Oppenheimer Rochester Amt-Free Municipal Fund, Oppenheimer Rochester Amt-Free New York Municipal Fund, Oppenheimer Rochester Michigan Municipal Fund, Oppenheimer Rochester Massachusetts Municipal Fund, Oppenheimer Rochester North Carolina Municipal Fund, Oppenheimer Rochester Minnesota Municipal Fund, and BlueMountain Capital Management, LLC, for and on behalf of investment funds for which it acts

as investment manager, were appellees in the First Circuit.

The Puerto Rico Electric Power Authority (PREPA) was a defendant in the district court but was not a party to the proceedings in the First Circuit.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

PARTIES TO THE PROCEEDINGS BELOW iii

INTRODUCTION 1

OPINIONS BELOW 3

JURISDICTION 4

PERTINENT STATUTORY PROVISIONS 4

STATEMENT OF THE CASE 4

A. Background 4

B. Proceedings Below 8

REASONS FOR GRANTING THE WRIT 9

I. Section 903(1) Does Not Preempt The Recovery Act 9

A. The Text, Structure, And History Of Section 903(1) Neither Compel Nor Allow A Conclusion Of Preemption 10

B. Background Preemption Principles Underscore That Section 903(1) Does Not Preempt The Recovery Act. 21

II. This Court Should Review This Important Question Of Federal Law 27

CONCLUSION 29

APPENDIX CONTENTS

First Circuit opinion,
July 6, 2015 ..... 1a

District Court opinion,
February 6, 2015 ..... 69a

Recovery Act (Official English version) 138a

Pertinent statutory provisions 272a

TABLE OF AUTHORITIES

Page(s)

Cases

Abbott v. United States,
562 U.S. 8 (2010) 13

Ashton v. Cameron Cty. Water Imp. Dist. No. 1,
298 U.S. 513 (1936).....25, 27

BFP v. Resolution Trust Corp.,
511 U.S. 531 (1994).....21

Bond v. United States,
134 S. Ct. 2077 (2014) 21, 22

City of Pontiac Retired Emps. Ass'n v. Schimmel,
751 F.3d 427 (6th Cir. 2014)
(*en banc*; *per curiam*).....11

Cohen v. de la Cruz,
523 U.S. 213 (1998).....16, 17

Doty v. Love,
295 U.S. 64 (1935) 25

Faitoute Iron & Steel Co. v. Asbury Park, N.J.,
316 U.S. 502 (1942).....17, 22, 26

FDA v. Brown & Williamson,
529 U.S. 120 (2000).....10

Graham Cty. Soil & Water Conserv. Dist. v. United States ex rel. Wilson,
559 U.S. 280 (2010).....10

Gregory v. Ashcroft,
501 U.S. 452 (1991).....21

Hanover Nat'l Bank v. Moyses,
186 U.S. 181 (1902).....24

Kellogg Brown & Root Servs. Inc. v. United States ex rel. Carter,
135 S. Ct. 1970 (2015) 16

King v. Burwell,
135 S. Ct. 2480 (2015) 10

Neblett v. Carpenter,
305 U.S. 297 (1938).....24

Ogden v. Saunders,
12 Wheat. (25 U.S.) 213 (1827) 23

Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp.,
485 U.S. 495 (1988).....21

Rice v. Santa Fe Elevator Corp.,
331 U.S. 218 (1947).....21

Richards v. United States,
369 U.S. 1 (1962) 10

Samantar v. Yousuf,
560 U.S. 305 (2010).....10

Stellwagen v. Clum,
245 U.S. 605 (1918).....24

Sturges v. Crowninshield,
4 Wheat. (17 U.S.) 122 (1819) 23

United States v. Bekins,
304 U.S. 27 (1938) 25, 26, 27

United States v. Morrow,
266 U.S. 531 (1925).....13

Whitman v. American Trucking Ass'ns,
531 U.S. 457 (2001).....17

Constitution, Statutes, and Rules

U.S. Const. art. I, § 8, cl. 4 23

11 U.S.C. § 101(40) 10
11 U.S.C. § 101(52) 5, 11, 15, 20
11 U.S.C. § 109(c) 5
11 U.S.C. § 901 *et seq.* 10, 11
11 U.S.C. § 903 ..... 10, 12-15
11 U.S.C. § 903(1) 2, 8-21
18 U.S.C. § 924(c) 13
28 U.S.C. § 1254(1) 4
Act of June 22, 1938, 75th Cong., 3d Sess., 52 Stat. 840 (1938) 16, 20
Act of May 24, 1934, 73rd Cong., 2d Sess., 48 Stat. 798 (1934) 25
Bankruptcy Act of 1898, 55th Cong., 2d Sess., 30 Stat. 544 (1898) 24
Pub. L. No. 98-353, 98 Stat. 333 (1984) 16
2014 P.R. Laws Act No. 71, § 115(b) 7
2014 P.R. Laws Act No. 71, § 202(a) 6
2014 P.R. Laws Act No. 71, § 202(d) 7
2014 P.R. Laws Act No. 71, § 202(d)(2)(A) 6
2014 P.R. Laws Act No. 71, § 202(d)(2)(B) 6
2014 P.R. Laws Act No. 71, § 301 7
2014 P.R. Laws Act No. 71, § 302 7
2014 P.R. Laws Act No. 71, § 304 7
2014 P.R. Laws Act No. 71, § 310 7
2014 P.R. Laws Act No. 71, § 312 7
2014 P.R. Laws Act No. 71, § 315(d) 7
2014 P.R. Laws Act No. 71, § 315(e) 7

General Law of Pennsylvania (1836).....24

Laws of the Territory of Michigan (1827).....24

Statutes of the State of Ohio of a General Nature (1854).....24

S. Ct. R. 10(c).....3, 27

Other Authorities

Corkery, Michael & Walsh, Mary Williams, *Puerto Rico's Governor Says Island's Debts Are "Not Payable,"* N.Y. TIMES, June 28, 2015.....28

H.R. Rep. No. 79-2246 (1946).....18

Hearings on H.R. 4307, 79th Cong. 16 (1946).....18

Lubben, Stephen J., *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. 553 (2014) 15, 19-20, 23-24

Mayer, Thomas Moers, *State Sovereignty, State Bankruptcy, & A Reconsideration of Chapter 9*, 85 Am. Bankr. L.J. 363 (2011).....13

S. Rep. No. 95-989 (1978).....18, 19

INTRODUCTION

This case involves Puerto Rico's ability to respond to the most acute fiscal crisis in its history. The Commonwealth's three major public utilities, which provide electricity, water, and roads for its citizens, have a combined debt of some $20 billion, which they cannot pay. But neither can those utilities simply shut down the electricity, or the water, or the roads. The utilities thus need to restructure their debts in a way that is fair not only to their creditors but also to the people they serve.

The decision below, however, holds that Puerto Rico—unlike the fifty States—lacks access to *any* legal mechanism to restructure the debts of its public utilities. It is undisputed that, since 1984, the federal Bankruptcy Code has precluded Puerto Rico from authorizing its "municipalities"—including, as relevant here, its public utilities—from restructuring their debts under Chapter 9 of the Code. But just because Puerto Rico's public utilities cannot restructure their debts under *federal* law does not mean that they cannot restructure their debts under *Commonwealth* law. Nothing in the federal Bankruptcy Code purports to leave a jurisdiction, like Puerto Rico, that is outside the scope of Chapter 9 in a "no man's land" where its public utilities cannot restructure their debts under *either* federal law *or* its own law.

To the contrary, it has been settled since the earliest days of the Republic that States and Territories have the power to enact their own restructuring laws. And it is equally settled that entities excluded from the federal Bankruptcy Code—such as banks and insurance companies—are

not thereby foreclosed from restructuring their debts under state or territorial law. There is thus no basis to conclude that the exclusion of Puerto Rico from Chapter 9 represents a limitation on the Commonwealth's power to create its own mechanism for restructuring the debts of its public utilities. Here, Puerto Rico exercised that power by enacting a statute—the Recovery Act—that creates such a restructuring mechanism.

The First Circuit, however, held that Puerto Rico has the worst of both worlds: it is not entitled to the *benefits* of Chapter 9, but remains subject to the *burdens* of Chapter 9. In particular, the First Circuit held that 11 U.S.C. § 903(1)—a provision of Chapter 9 that sharply limits the ability of jurisdictions within the scope of that Chapter to restructure their debts beyond the scope of that Chapter—preempts the Recovery Act.

The court thereby turned Chapter 9 on its head. Section 903(1) is part and parcel of Chapter 9: on the one hand, Congress created a federal mechanism for States to restructure their municipal debts while, on the other, Congress limited their ability to restructure those debts outside that mechanism. It makes no sense to read a limitation on Chapter 9 to apply to a jurisdiction, like Puerto Rico, that is outside the scope of that Chapter in the first place.

Indeed, it is anomalous in the extreme to think that Congress—*sub silentio* and through an amendment to a statutory definition—foreclosed Puerto Rico from access to *any* legal mechanism for restructuring the debts of its public utilities, which provide basic and essential services to its citizens. Nor is it any answer to assert, as did the First

Circuit, that Puerto Rico can always ask Congress to change the law: the question here is whether the law should be interpreted in such an anomalous and draconian manner in the first place.

This is one of the rare cases that calls for this Court's immediate review even in the absence of a conflict among the lower courts. Given the anomalous treatment of Puerto Rico in the federal Bankruptcy Code, no circuit split is realistically possible here. And anyone who has even glanced at the headlines in recent months knows that the Commonwealth is in the midst of a financial meltdown that threatens the island's future. By holding that the federal Bankruptcy Code precludes Puerto Rico's public utilities from restructuring their debts not only under federal law but also under Commonwealth law, the First Circuit decided "an important question of federal law that has not been, but should be, settled by this Court." S. Ct. R. 10(c). And because that decision leaves Puerto Rico's public utilities, and the 3.5 million American citizens who depend on them, at the mercy of their creditors, this Court's review is warranted—and soon.

OPINIONS BELOW

The First Circuit's decision has not yet been published in the Federal Reporter, but is reported at 2015 WL 4079422 and reprinted in the Appendix ("App.") at 1-68a. Similarly, the district court's opinion has not yet been published, but is reported at 2015 WL 522183 and reprinted at App. 69-137a.

JURISDICTION

The First Circuit issued its decision on July 6, 2015. App. 1-2a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

PERTINENT STATUTORY PROVISIONS

Pertinent statutory provisions are set forth in the Appendix.

STATEMENT OF THE CASE

A. Background

This case arises out of a fiscal crisis that has crippled Puerto Rico. *See* Recovery Act Stmt. of Motives, App. 139-40a. In recent years, the Commonwealth has faced an economic recession, high unemployment, and a declining population, all of which have contributed to a declining tax base and decreased revenues. *Id.*, App. 147-48a. In January 2013, the Commonwealth's deficit for fiscal year 2012-13 was projected to exceed $2.2 billion. *Id.*, App. 139a. Even after significant budget cuts, the deficit for that fiscal year ultimately exceeded $1.2 billion. *Id.* And, despite additional fiscal discipline measures approved by the Legislative Assembly, the deficit for the 2013-14 fiscal year reached $650 million. *Id.* Under these circumstances, the Legislative Assembly declared a state of "fiscal emergency" early last year. *Id.*, App. 144-45a, 166a.

The fiscal crisis has hit the Commonwealth's public utilities particularly hard. The combined deficit of the three main public utilities in fiscal year 2012-13 was approximately $800 million, and their overall combined debt reached $20 billion. *Id.*, App. 139-40a. For the first time in the Commonwealth's history, the principal rating agencies downgraded

the Commonwealth's general obligation bonds (and the bonds of most of its public utilities) to below investment grade. *Id.*, App. 141a. The attendant increases in interest rates, along with the reduction in access to capital markets, have further limited these corporations' liquidity and financial flexibility. *Id.*, App. 141-42a.

Among the public corporations most acutely affected by the current fiscal crisis is the Puerto Rico Electric Power Authority (PREPA), which employs over 7,000 people and supplies virtually all of the Commonwealth's electric power. In recent years, PREPA has experienced severe reductions in its net revenues and has incurred net losses and cash flow shortfalls due to the prolonged weakness in the Commonwealth's macroeconomic conditions (high energy, labor, and maintenance costs) and investments in capital improvements. *Id.*, App. 145-46a. PREPA's utility rates, which are twice the average rate in the continental United States, have adversely affected the Commonwealth's economic development and stifled necessary capital investments. *Id.*, App. 146-47a.

When faced with similar crisis conditions, the fifty States may authorize their public utilities to restructure under Chapter 9 of the federal Bankruptcy Code. *See* 11 U.S.C. § 109(c), App. 274-75a. Puerto Rico's public utilities, in contrast, are categorically excluded from restructuring their debts under Chapter 9. *See* 11 U.S.C. § 101(52), App. 273a. Accordingly, the Commonwealth enacted the Recovery Act last year to allow those entities to restructure their debts in a fair and orderly manner. *See* Recovery Act Stmt. of Motives, App. 149-55a. As

the Legislative Assembly explained, "the current fiscal emergency situation requires legislation that allows public corporations, among other things, (i) to adjust their debts in the interest of all creditors affected thereby, (ii) provides procedures for the orderly enforcement and, if necessary, the restructuring of debt in a manner consistent with the Commonwealth Constitution and the U.S. Constitution, and (iii) maximizes returns to all stakeholders by providing them going concern value based on each obligor's capacity to pay." *Id.*, App. 154a. The Act thus creates a mechanism for Puerto Rico's public corporations to restructure their debts so that they can continue to provide essential public services like dependable electricity and clean water while at the same time protecting their creditors. *Id.*; *see also id.*, App. 144a (Recovery Act will allow public corporations to continue to provide "services necessary and indispensable for the populace").

To that end, the Act establishes two types of procedures to address a public corporation's debt burden. The first, set forth in Chapter 2, is a market-based approach that contemplates limited court involvement. *See id.* Ch. 2, App. 157-60a (summary), 210-20a. Under this Chapter, a public corporation chooses debts to renegotiate with its creditors. *See id.* § 202(a), App. 211a. Creditors representing at least 50% of the debt in a given class must participate in the vote on whether to accept those changes, and at least 75% of participants must approve them. *See id.* § 202(d)(2)(A)-(B), App. 213a. Once Puerto Rico's Government Development Bank (GDB) and a specialized court established by the Act approve the consensual debt relief transaction, the instruments governing the creditors' claims are

deemed amended to reflect the renegotiated terms. *See id.* § 202(d), App. 212-13a; *id.* § 115(b), App. 187-88a.

The Act also allows Puerto Rico's public utilities to seek relief under Chapter 3, which involves enhanced judicial oversight and is modeled on Chapter 9 of the federal Bankruptcy Code. *Id.*, App. 160-64a (summary); App. 221-71a. To file under Chapter 3, a public utility files a petition that includes a list of affected creditors and a schedule of claims, which stays a broad range of actions against the petitioner. *See id.* §§ 301, 302, 304, App. 221-27a. Either the GDB or the petitioner must then file a proposed plan or proposed transfer of the utility's assets, which the court can confirm only if it "provides for every affected creditor in each class of affected debt to receive payments and/or property having a present value of at least the amount the affected debt in the class would have received if all creditors holding claims against the petitioner had been allowed to enforce them on the date the petition was filed." *Id.* §§ 310, 315(d), App. 234a, 238a. At least one class of affected debt must accept the plan with a majority of all votes cast and with the support of at least two-thirds of affected debt in the class. *See id.* §§ 312, 315(e), App. 235-36a, 238a. As under Chapter 2, all affected creditors are bound by the plan after it is approved by the specialized court. *See id.* § 115(b), App. 187-88a.

The Puerto Rico Legislature passed the Recovery Act on June 25, 2014, and the Governor signed it into law just three days later.

B. Proceedings Below

On June 28, 2014—the very day that the Governor signed the Recovery Act into law—some of the respondents (investment funds that hold PREPA bonds) filed a lawsuit challenging the Act's validity and seeking declaratory and injunctive relief. Several weeks later, the remaining respondents (also PREPA bondholders) filed a similar lawsuit. The lawsuits alleged, among other things, that the Recovery Act is preempted by Section 903(1), a provision of Chapter 9 of the Bankruptcy Code.

In February 2015—without hearing oral argument—the district court (Besosa, J.) denied petitioners' motion to dismiss, granted summary judgment to the respondents who had requested it, and permanently enjoined petitioners from enforcing the Recovery Act. *See* App. 69-137a. As relevant here, the court agreed with respondents that the Act is preempted by Section 903(1), even though Chapter 9 does not apply to Puerto Rico in the first place. *See* App. 94-111a.

Petitioners appealed, but the First Circuit affirmed. *See* App. 1-68a. The panel majority agreed with the district court that Section 903(1) expressly preempts the Recovery Act, *see* App. 21-41a, and in addition held that the Act would frustrate the purpose of that provision, *see* App. 41-43a. Judge Torruella concurred in the judgment invalidating the Recovery Act, but opined that Chapter 9 is unconstitutional insofar as it excludes Puerto Rico from its scope. *See* App. 46-68a.

This petition follows.

REASONS FOR GRANTING THE WRIT

I. Section 903(1) Does Not Preempt The Recovery Act.

The decision below reflects a fundamental misunderstanding not only of federal bankruptcy law but also of federalism. The First Circuit wrenched a single provision of Chapter 9—Section 903(1)—from its statutory context and treated it as a free-floating provision of the U.S. Code. The court thereby violated basic principles of statutory interpretation. Section 903(1) is a proviso to a clause that does not apply to Puerto Rico, located within a chapter of the Bankruptcy Code that does not apply to Puerto Rico. The statutory context thus makes clear that Section 903(1) does not apply to Puerto Rico, and the history of that provision only confirms the point.

That point is further reinforced by background preemption principles, which apply with full force to Puerto Rico. In our federal system, the general rule is that Congress does not lightly displace the legislative powers of the States and Territories, and there is no indication that it wished to do so here. And it is particularly implausible to assume that Congress meant to deprive Puerto Rico's public utilities—which provide the Commonwealth's people with essential public services like electricity, water, and roads—of any legal mechanism to restructure their debts, thereby leaving them at the mercy of their creditors. If Congress wanted Chapter 9 to be the sole method of restructuring municipal debt, even for jurisdictions categorically ineligible for Chapter 9 relief, it could and would have said so.

A. The Text, Structure, And History Of Section 903(1) Neither Compel Nor Allow A Conclusion Of Preemption.

The decision below violates the cardinal rule that courts must read the words of a statute "'in their context and with a view to their place in the overall statutory scheme.'" *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015) (quoting *FDA v. Brown & Williamson*, 529 U.S. 120, 133 (2000)). "Our duty, after all, is 'to construe statutes, not isolated provisions.'" *Id.* (quoting *Graham Cty. Soil & Water Conserv. Dist. v. United States ex rel. Wilson*, 559 U.S. 280, 290 (2010)). This is hardly a novel or controversial proposition. *See id.* at 2497 (Scalia, J., joined by Thomas & Alito, JJ., dissenting) ("I wholeheartedly agree with the Court that sound interpretation requires paying attention to the whole law, not homing in on isolated words or even isolated sections. Context always matters."); *see also Samantar v. Yousuf*, 560 U.S. 305, 319 (2010); *Richards v. United States*, 369 U.S. 1, 11 (1962).

Chapter 9 of the Bankruptcy Code exists to permit a municipality—*i.e.*, a "political subdivision or public agency or instrumentality of a State," 11 U.S.C. § 101(40), App. 272a—to restructure its debts under federal law. Every section of Chapter 9 works in service to that end. *See* 11 U.S.C. §§ 901-46. Section 903(1) is no exception. Section 903 expressly "reserve[s] ... State power to control municipalities," 11 U.S.C. § 903, App. 279a, and Section 903(1) ensures that States eligible to participate in Chapter 9 cannot undermine the federal scheme by limiting the relief that they can provide their municipalities under state law.

The First Circuit, however, focused myopically on Section 903(1), as if that provision resolved this case. *See* App. 21-41a. But the Commonwealth has never disputed that Section 903(1), if applicable to Puerto Rico, would preempt the Recovery Act. By its terms, that provision specifies that "a State law prescribing a method of composition of indebtedness of [a] municipality may not bind any creditor that does not consent to such composition." 11 U.S.C. § 903(1), App. 279a. The question here, however, is not whether Section 903(1), if applicable, would preempt the Recovery Act, but whether Section 903(1) applies to Puerto Rico in the first place.

The answer to that question is "no." Section 903(1) is not a standalone part of the U.S. Code. To the contrary, it is a proviso to Section 903, which in turn is part of Chapter 9. And the entire point of Chapter 9, as noted above, is to create a mechanism for a municipality to restructure its debts under federal law, *see id.* §§ 901-46; *see also City of Pontiac Retired Emps. Ass'n v. Schimmel*, 751 F.3d 427, 433 (6th Cir. 2014) (*en banc*; *per curiam*) (McKeague, J., joined by Batchelder, C.J., concurring) ("[Section] 903(1) does not exist in a vacuum," but "is part of, and in fact an *exception* to, the main point of a longer sentence.") (emphasis in original).

The First Circuit did not, and could not, deny that Puerto Rico's municipalities are categorically ineligible to restructure their debts under Chapter 9. *See id.* § 101(52), App. 273a. For that reason, there is no basis to apply Section 903(1), which is concededly part of Chapter 9, to those municipalities. Chapter 9 offers States—but not Puerto Rico—the *option* of allowing their municipalities to seek federal

bankruptcy protection. In exchange for providing that federal option, Congress limited the relief that States could provide those municipalities under their own laws. *See id.* § 903(1), App. 279a. In other words, Congress required States to take the bitter with the sweet. There is absolutely nothing in the text, structure, or history of the statute to suggest that Congress required Puerto Rico to take *only* the bitter without the sweet: a limitation on the relief it can provide municipalities under its own law *without* the option of authorizing those municipalities to restructure their debts under federal law.

Indeed, Section 903 has no legal or logical application to a jurisdiction, like Puerto Rico, that cannot authorize its municipalities to seek relief under Chapter 9. By its terms, Section 903 specifies that "*[t]his Chapter* [*i.e.*, Chapter 9] does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise." *Id.* § 903, App. 279a (emphasis added). That "Reservation of State power to control municipalities" does not apply to Puerto Rico, which cannot authorize its municipalities to seek relief under "this chapter." *Id.* Chapter 9, in other words, cannot "limit or impair" the power of a jurisdiction to which it does not apply in the first place. *Id.* Because Section 903 simply negates an inference that cannot apply to Puerto Rico, Section 903 does not apply to Puerto Rico: it would be nonsensical for Congress to provide Puerto Rico with a shield against intrusion by a Chapter that, by definition, can have no effect on Puerto Rico.

And Section 903(1), by its plain terms, is nothing more than a proviso to Section 903. In particular, Section 903(1) excepts certain relief from the "power of a State to control ... a municipality of or in such State" that is otherwise "[r]eserv[ed]" by Section 903. 11 U.S.C. § 903, App. 279a. Thus, if Section 903 does not apply to Puerto Rico, it follows that Section 903(1) does not apply to Puerto Rico either. *See, e.g.*, *United States v. Morrow*, 266 U.S. 531, 534-35 ("[A proviso's] grammatical and logical scope is confined to the subject matter of the principal clause."); *id.* at 535 ("[T]he presumption is that, in accordance with its primary purpose, [a proviso] refers only to the provision to which it is attached."); *Abbott v. United States*, 562 U.S. 8, 30 (2010) ("As a proviso attached to § 924(c), the 'except' clause is most naturally read to refer to the conduct § 924(c) proscribes."); Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, & A Reconsideration of Chapter 9*, 85 Am. Bankr. L.J. 363, 379 n.84 (2011) ("[Section 903(1)] appears as an exception to § 903's respect for state law in chapter 9 and thus appears to apply only in a chapter 9 bankruptcy."). Indeed, Section 903(1) includes a textual reference ("such municipality") back to Section 903, thereby underscoring that the two provisions not only *may* but *must* be read in tandem. 11 U.S.C. § 903(1), App. 279a.

The First Circuit never sought to explain how Section 903 applies to Puerto Rico, or how Section 903(1) applies to Puerto Rico if Section 903 does not. Instead, the First Circuit caricatured petitioners' contextual argument, asserting that it would require the court to "accept one of the two following propositions: Either states that do not authorize

their municipalities to file for Chapter 9 relief are similarly 'exempted,' and so not barred by § 903(1) from enacting their own bankruptcy laws. Or the availability of Chapter 9 relief for state municipalities, regardless of whether a particular state chooses to exercise the option, occupies the field of nonconsensual municipal debt restructuring, and § 903(1) merely aims to clarify that the operative clause of § 903 does not undermine that background assumption." App. 40a. But petitioners' contextual interpretation of § 903(1) does not require acceptance of either proposition.

The first proposition is a straw man because petitioners' contextual interpretation rests on the premise that Section 903(1) does not apply to a jurisdiction, like Puerto Rico, that is categorically ineligible to invoke the Chapter 9 restructuring regime. The interpretation thus has no application to the States, which always have the *option* of authorizing their municipalities to file under Chapter 9, even if they decline to exercise that option. It does not follow, thus, that if Section 903(1) does not apply to Puerto Rico, then Section 903(1) does not apply to a State that has not authorized its municipalities to seek Chapter 9 protection.

The second proposition is simply perplexing, because petitioners' contextual interpretation does not involve "field preemption," or any other form of preemption. To the contrary, it recognizes a *limitation* on a provision, Section 903(1), that otherwise would have preemptive effect: that provision cannot apply more broadly than the principal clause that it modifies. The First Circuit's assertion that "ironically, it is [petitioners']

argument which relies on the notion of field preemption," App. 40a, is thus baffling.

Similarly, the First Circuit begged the question by asserting that "[i]f Congress had wanted to alter the applicability of § 903(1) to Puerto Rico, it easily could have written § 101(52) to exclude Puerto Rico laws from the prohibition of § 903(1)." App. 28a (internal quotation omitted). Congress wrote Section 101(52) in a way that renders Puerto Rico municipalities categorically ineligible for Chapter 9 relief by precluding Puerto Rico from authorizing them to seek such relief. Congress thereby took Puerto Rico outside the scope of Chapter 9: the word "State" appears nowhere in that Chapter *besides* Section 903, and—as explained above—Section 903 (and hence Section 903(1)) has no application to a jurisdiction, like Puerto Rico, that cannot authorize its municipalities to seek Chapter 9 relief. If Congress had wanted Section 903(1) to bind Puerto Rico, it hardly could have expressed that intent in a more roundabout way than through an exception to a rule that does not apply to Puerto Rico in a Chapter of the Code that does not apply to Puerto Rico.

The far more natural interpretation is that Chapter 9's reorganization regime *neither* encompasses Puerto Rico *nor* displaces Commonwealth law. *See* Stephen J. Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 576 (2014) ("[S]ection 903 was only intended to apply to debtors who might actually file under chapter 9."). In other words, Congress created a mechanism for States to allow their municipalities to restructure their debts under *federal* law, and thereafter limited the relief that States could provide

those same municipalities under *state* law. Nothing in Section 903(1), or any other provision of the Bankruptcy Code, suggests that Congress sought to displace state restructuring law where federal restructuring law is unavailable.

The First Circuit's reliance on the history of Section 903(1) is equally misplaced. The court placed great weight on the fact that Puerto Rico, like other other territories and possessions, was included within the definition of "State" from 1938 until the overhaul of the Bankruptcy Code in 1978. App. 16a & n.12, 26a (citing Act of June 22, 1938, Ch. 575 § 1(29), 75th Cong., 3d Sess., 52 Stat. 840, 842 (1938)) (defining "State" in relevant part to "include the territories and possessions to which this title is or may hereafter be applicable, Alaska, and the District of Columbia"). It follows, the First Circuit declared, that Puerto Rico was covered by Section 903(1) at that time, and there is no indication that Congress intended to "'erode past bankruptcy practice'" when, in 1984, it precluded Puerto Rico from authorizing its municipalities to restructure their debts under Chapter 9. App. 4a, 23-24a (quoting *Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998)). "'Fundamental changes in the scope of a statute are not typically accomplished with so subtle a move.'" App. 4a, 26-27a (quoting *Kellogg Brown & Root Servs. Inc. v. United States ex rel. Carter*, 135 S. Ct. 1970, 1977 (2015)).

But there was nothing at all "subtle" about Congress' enactment of a new definition of "State" in 1984. *See* Bankruptcy Amendments & Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(j)(6), 98 Stat. 333 (1984). Congress thereby

expressly and substantially altered the reach of the Code. Because Congress unquestionably "erode[d] past bankruptcy practice," *Cohen*, 523 U.S. at 221, by stripping Puerto Rico of the benefits of Chapter 9, there is no reason to suppose that Congress intended to preserve past bankruptcy practice by continuing to subject Puerto Rico to the burdens of Chapter 9. In short, if there is any "elephant" hidden in a "mousehole" here, *see Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 468 (2001), it is the suggestion that Congress' decision to preclude Puerto Rico municipalities from restructuring their debts under Chapter 9 leaves those municipalities subject to limitations in Chapter 9 that preclude them from restructuring their debts under *any* legal regime.

The legislative history also provides no support for the decision below. As the First Circuit acknowledged, "[t]he legislative history is silent as to the reason for the exception set forth in the 1984 amendment." App. 28a. Thus, nothing in the legislative history suggests that Congress intended the 1984 amendment to deny Puerto Rico municipalities access not only to Chapter 9 but to any legal mechanism to restructure their debts.

Nor, contrary to the First Circuit's suggestion, *see* App. 24-28a, does the legislative history of Section 903(1)—which *predates* the 1984 amendment—support the decision below. The precursor to Section 903(1) was first added to the U.S. Code in 1946, in the wake of a decision by this Court holding that the enactment of Chapter 9 did not preempt state municipal-restructuring laws. *See Faitoute Iron & Steel Co. v. Asbury Park, N.J.*, 316 U.S. 502, 508-09 (1942). The legislative history of the 1946

amendment showed that Congress wanted to expand the preemptive scope of Chapter 9:

> State adjustment acts have been held to be valid, but a bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the 48 States, as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent.

H.R. Rep. No. 79-2246, at 4 (1946). And, when Congress retained and recodified this provision as part of an overhaul of the Bankruptcy Code in 1978, it noted that "[d]eletion of the provision would permit all States to enact their own versions of Chapter IX, ... which would frustrate the constitutional mandate of uniform bankruptcy laws." S. Rep. No. 95-989, at 110 (1978) (internal quotation omitted).

But none of this legislative history says anything about what happens where, as here, *Congress itself* departs from the uniformity of federal bankruptcy law by excluding a jurisdiction, like Puerto Rico, from Chapter 9. To the contrary, the legislative history of Section 903(1) *presupposes* the availability of a federal mechanism for restructuring municipal debts. *See Hearings on H.R. 4307*, 79th Cong. 16 (1946) (statement of Millard Parkhurst) (precursor to Section 903(1) intended to prevent States from "hav[ing] their bankruptcy laws running right along at the same time as [Chapter 9]"). And that is perfectly understandable because, at the time the legislative history was written, no jurisdiction was

excluded from Chapter 9. Insofar as Section 903(1) was motivated by a concern that state municipal bankruptcy laws might "frustrate the constitutional mandate of uniform bankruptcy laws," S. Rep. No. 95-989, at 110 (1978), that concern sheds no light on the consequences of Congress' decision to *exclude* a jurisdiction from the scope of Chapter 9, which represents a departure from the uniformity of federal bankruptcy law. In short, the First Circuit vastly overread the legislative history of Section 903(1) to resolve an issue it did not address.

For that reason, the First Circuit's distinct "conflict preemption" argument also fails. *See* App. 41-43a. The First Circuit held that, quite apart from the text of Section 903(1), "[c]onflict preemption applies here because the Recovery Act frustrates Congress's undeniable purpose in enacting § 903(1)." App. 42a. The court based that holding on the premise that, in light of the legislative history quoted above, "Congress quite plainly wanted a single federal law to be the sole source of authority if municipal bondholders were to have their rights altered without their consent." *Id.* But that premise is baseless. As noted above, nothing in the legislative history suggests that Congress wanted Chapter 9 to be the sole recourse for debtors *excluded* from Chapter 9.

The Recovery Act represents Puerto Rico's considered decision to fill the gap left by the inapplicability of Chapter 9 to the Commonwealth's public utilities. *See* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 567 ("Puerto Rico's new Recovery Act is addressed to a class of debtors who are expressly excluded from

chapter 9 of the Bankruptcy Code by virtue of the exclusion of Puerto Rico from the definition of State 'for the purpose of defining who may be a debtor under chapter 9.' As such, there is no way for the Recovery Act to conflict with chapter 9 in violation of Congress' powers under the Bankruptcy Clause."); *id.* at 577 ("[I]t is emphatically possible to apply the Recovery Act and the Bankruptcy Code simultaneously, because the Bankruptcy Code has nothing to say about Puerto Rican municipal corporations. The two laws are mutually exclusive.").

Indeed, the First Circuit's broad and non-textual "conflict preemption" theory works considerable collateral damage with respect to other possessions and territories. Only Puerto Rico and the District of Columbia are encompassed in any way by the Bankruptcy Code's current definition of "State," *see* 11 U.S.C. § 101(52), App. 273a—in sharp contrast to the Code's previous definition of "State," which (as noted above) included "the Territories and possessions to which this Act is or may hereafter be applicable, Alaska, and the District of Columbia," Act of June 22, 1938, Ch. 575 § 1(29), 75th Cong., 3d Sess., 52 Stat. 840, 842 (1938). The First Circuit's "conflict preemption" theory, however, prevents other possessions and territories (*e.g.*, the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands) from enacting legislation to allow their public utilities to restructure their debts, even though they are not even arguably covered by Section 903(1) in any way. *See* App. 16a n.12 (acknowledging that these other jurisdictions "are not expressly included for *any* purpose") (emphasis added). The decision

below, in short, unsettles municipal restructuring law in ways that go well beyond this case.

B. Background Preemption Principles Underscore That Section 903(1) Does Not Preempt The Recovery Act.

The decision below also flouts background preemption principles that apply with full force to Puerto Rico. In our federal system, "[i]t has long been settled ... that we presume federal statutes do not ... preempt state law." *Bond v. United States*, 134 S. Ct. 2077, 2088 (2014) (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Although Puerto Rico is not a State, this Court has long "agree[d]" that "the test for federal preemption of the law of Puerto Rico ... is the same as the test under the Supremacy Clause." *Puerto Rico Dep't of Consumer Affairs v. Isla Petroleum Corp.*, 485 U.S. 495, 499 (1988).

"Closely related" to the presumption against preemption "is the well-established principle that 'it is incumbent upon the federal courts to be certain of Congress' intent before finding that federal law overrides' the 'usual constitutional balance of federal and state powers.'" *Bond*, 134 S. Ct. at 2089 (quoting *Gregory v. Ashcroft*, 501 U.S. 452, 460 (1991)) (further internal quotation omitted). Thus, "if the Federal Government would 'radically readjust the balance of state and national authority, those charged with the duty of legislating must be reasonably explicit' about it." *Id.* (quoting *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994)) (further internal quotation omitted).

Here, the First Circuit applied Section 903(1), a proviso to a clause that does not apply to Puerto

Rico, located in a Chapter of the Code that does not apply to Puerto Rico, to strip Puerto Rico of the ability to respond to "problems as peculiarly local as the fiscal management of its own household." *Faitoute*, 316 U.S. at 508-09. Yet far from ensuring that Congress was "reasonably explicit" about such a far-reaching choice, *Bond*, 134 S. Ct. at 2089 (internal quotation omitted), the First Circuit applied a provision that predates the exclusion of Puerto Rico from Chapter 9 and does not purport to preempt the restructuring laws of jurisdictions beyond the scope of Chapter 9.

Despite the First Circuit's protestations to the contrary, its decision places Puerto Rico in an anomalous "no man's land" in which its public utilities lack access to *any* legal mechanism to restructure their debts, and are thus left wholly at the mercy of their creditors. *See* App. 29-31a n.24. The First Circuit declared that Puerto Rico is not in such a "no man's land" because it can always ask Congress to change the law. *See id.* But Congress' power to free Puerto Rico from the current "no man's land" does not negate the existence of that "no man's land" in the first place: the point remains that, absent some future Act of Congress, the decision below leaves Puerto Rico powerless to authorize its public utilities to restructure their debts under any law. If Congress had intended to take so consequential a step, it surely could and would have said so.

Nor is there any support for the First Circuit's suggestion that Congress sought to reserve for itself the option of authorizing Puerto Rico's municipalities to restructure their debts, on the theory that "[i]f

Puerto Rico could determine the availability of Chapter 9 for Puerto Rico municipalities, that might undermine Congress's ability to do so." App. 29a; *see also id.* ("Congress's ability to exercise such other options would also be undermined if Puerto Rico could fashion its own municipal bankruptcy relief."). As Judge Torruella bluntly put it, these suggestions are "pure fiction" without any basis in fact or law. App. 53a. "There is absolutely nothing in the record of the 1984 Amendments to justify" the panel majority's statements regarding congressional intent. *Id.*; *see generally* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 578 ("[T]here seems to be no good reason why [the exclusion of Puerto Rico from Chapter 9] should leave Puerto Rico entirely helpless to address the plight of its public corporations. ... The bondholders are entitled to insist that that every effort be made to honor their contracts, but the citizens of Puerto Rico are also entitled to receive the basic services, like electricity, provided by these entities.").

Finally, the First Circuit erred by declaring that the presumption against preemption is "weak, if present at all" in this case. App. 36a. Although the Bankruptcy Clause of the federal Constitution gives Congress "the power ... [t]o establish ... uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const. art. I, § 8, cl. 4, it has long been settled that this power does not prevent States and Territories from enacting their own laws governing the restructuring of debts, *see, e.g.*, *Ogden v. Saunders*, 12 Wheat. (25 U.S.) 213, 368 (1827); *Sturges v. Crowninshield*, 4 Wheat. (17 U.S.) 122, 193-97 (1819); *see generally* Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 563-

68. Indeed, during the first century under the Constitution, a federal bankruptcy law was in effect for a total of only 16 years; it was not until 1898 that the precursor of the modern Bankruptcy Code was enacted. *See* Bankruptcy Act of 1898, Ch. 541, 55th Cong., 2d Sess., 30 Stat. 544 (1898); *see generally Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 184 (1902) (describing history). During that time, States and Territories routinely enacted their own legislation governing restructuring of debts. *See, e.g.*, Laws of the Territory of Michigan 333 (1827) ("An Act for the Relief of Insolvent Debtors"); 1 General Law of Pennsylvania 710 (1836) ("An Act Relating to Insolvent Debtors"); 1 Statutes of the State of Ohio of a General Nature, ch. 57, at 456 (1854) ("Insolvent Debtors").

Thus, there is no "dormant Bankruptcy Clause" akin to the "dormant Commerce Clause" that precludes States and Territories from adopting restructuring legislation absent authorization by Congress. *See, e.g.*, Lubben, *Puerto Rico & The Bankruptcy Clause*, 88 Am. Bankr. L.J. at 554, 578. It follows, as this Court has explained, that state and territorial laws in this area are "suspended *only* to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress." *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) (emphasis added). That explains why this Court has long upheld state restructuring or liquidation laws applicable to entities—like banks or insurance companies—excluded from the scope of the federal Bankruptcy Code. *See, e.g.*, *Neblett v. Carpenter*, 305 U.S. 297, 303-05 (1938) (upholding state statute governing rehabilitation of an insurance company); *Doty v.*

Love, 295 U.S. 64, 70-74 (1935) (upholding state statute governing reorganization of a bank).

Indeed, States and Territories have an especially compelling interest in safeguarding the fiscal health of their *own* public corporations, agencies, and instrumentalities. Thus, it was not until 1934 that Congress first extended the federal Bankruptcy Code to encompass such entities at all. *See* Act of May 24, 1934, Ch. 345, 73rd Cong., 2d Sess., 48 Stat. 798 (1934). And that legislation did not survive judicial scrutiny: in light of background principles of federalism, this Court struck down the law on the ground that Congress' constitutional power over bankruptcy did not extend to this context. *See Ashton v. Cameron Cty. Water Imp. Dist. No. 1*, 298 U.S. 513, 529-32 (1936). Were the 1934 Act permitted to stand, the Court declared, States would be "no longer free to manage their own affairs," and "the sovereignty of the state, so often declared necessary to the federal system, [would] not exist." *Id.* at 531.

It was not until 1938 that this Court first interpreted the Bankruptcy Clause to allow Congress to enact a federal municipal bankruptcy law. *See United States v. Bekins*, 304 U.S. 27, 51-52 (1938). And even then, the Court did not overrule its earlier precedents, but simply held that the statute in question (a precursor to Chapter 9) was "carefully drawn so as not to impinge on the sovereignty of the State." *Id.* at 50-51. The Court emphasized that the redrawn statute allowed "[t]he State [to] retain[] control of its fiscal affairs" by permitting municipal restructuring under federal law "only in a case where

[the federal restructuring] is authorized by state law." *Id.* at 51.

And, just four years after upholding the constitutionality of the federal municipal bankruptcy regime, this Court squarely rejected the suggestion that the enactment of that regime divested States and Territories of the power to enact their own municipal restructuring laws. *See Faitoute*, 316 U.S. at 508-09. As the Court explained, "[n]ot until April 25, 1938, was the power of Congress to afford relief similar to that given by New Jersey for its municipalities clearly established." *Id.* at 508 (citing the date on which *Bekins* upheld the municipal restructuring provisions of the federal Bankruptcy Code against a constitutional challenge). "Can it be that a power that was not recognized until 1938, and when so recognized, was carefully circumscribed to reserve full freedom to the states, has now been completely absorbed by the federal government—that a state which ... has ... devised elaborate machinery for the autonomous regulation of problems as peculiarly local as the fiscal management of its own household, is powerless in this field? We think not." *Id.* at 508-09.

Accordingly, there is no basis for the First Circuit's suggestion that the presumption against preemption is "weak, if present at all," App. 36a, in this case. To the contrary, as noted above, a State or Territory's ability to address "problems as peculiarly local as the fiscal management of its own household" lies at the very core of its autonomy. *Faitoute*, 316 U.S. at 508-09; *see also id.* at 512 ("The intervention of the State in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital

interests of its people by sustaining the public credit and maintaining local government."). That is why, as this Court has emphasized, Congress lacks plenary power to enact bankruptcy legislation applicable to the States' political subdivisions or instrumentalities, and why such legislation must be "carefully" tailored to permit States to "retain[] control of [their] fiscal affairs." *Bekins*, 304 U.S. at 51; *see also Ashton*, 298 U.S. at 528-32.

II. This Court Should Review This Important Question Of Federal Law.

As Judge Torruella noted in his separate opinion below, "[t]his is an extraordinary case involving extraordinary circumstances, in which the economic life of Puerto Rico's three-and-a-half million U.S. citizens hangs in the balance." App. 63a (opinion concurring in the judgment). The First Circuit's decision leaves Puerto Rico powerless to restructure the debts of its public utilities under *any* law. The question whether the federal Bankruptcy Code requires this unprecedented and anomalous result is "an important question of federal law that has not been, but should be, settled by this Court." S. Ct. R. 10(c).

As a practical matter, there is no realistic prospect of further percolation of this issue among the lower courts. None of the other jurisdictions outside the scope of Chapter 9 has enacted its own municipal restructuring law, so the issue is not presented elsewhere. Nor is there any prospect of further litigation with respect to the validity of Puerto Rico's Recovery Act: unless and until this Court overturns the decision below, the Act is a nullity. Because no circuit split is realistically possible here, there is no

basis for this Court to defer review pending the development of such a split.

And it is hard to overstate the importance of this issue to the future of Puerto Rico and its people. As the Governor recently explained, the island now finds itself caught in a "death spiral" where it can neither pay nor restructure its debts. Michael Corkery & Mary Williams Walsh, *Puerto Rico's Governor Says Island's Debts Are "Not Payable,"* N.Y. TIMES, June 28, 2015, at A1. In the absence of a restructuring regime, individual creditors have every incentive to "hold out" on any prospective agreement in an effort to obtain more favorable terms, even though creditors as a whole may have an interest in working out a restructuring plan that would enhance their collective recovery. *See generally* App. 10a n.6. The Recovery Act created such a restructuring regime, and the question whether it is preempted by the federal Bankruptcy Code—which offers Puerto Rico no alternative restructuring regime—warrants this Court's review.

Nor is it a practical answer to say that Puerto Rico can seek relief from Congress. Puerto Rico would certainly welcome legislative relief from its inexplicable (and unexplained) exclusion from Chapter 9, and has sought legislation to that end. But those long ongoing efforts have thus far proven fruitless—in part because of the furious opposition of certain bondholders (especially hedge funds that purchased the bonds at a substantial discount and now seek to make windfall profits in the absence of a restructuring regime). Indeed, Judge Torruella went out of his way to "take issue with the majority's proposal that Puerto Rico simply ask Congress for

relief; such a suggestion is preposterous given Puerto Rico's exclusion from the federal political process." App. 48a; *see also* App. 65a ("[W]hen Puerto Rico is effectively excluded from the political process in Congress, this is asking it to play with a deck of cards stacked against it.").

At the end of the day, Congress treated Puerto Rico without the dignity due the millions of American citizens who live there by arbitrarily excluding the Commonwealth from Chapter 9, and the lower courts in this case were equally dismissive of the Commonwealth's compelling interest in providing an alternative means for its public utilities to restructure their debts. Before the Commonwealth and its people are left at the mercy of their creditors, they deserve a definitive answer from this Court as to whether the Recovery Act is preempted by federal law.

CONCLUSION

For the foregoing reasons, the Court should grant this petition for writ of certiorari.

Respectfully submitted,

CÉSAR MIRANDA
RODRÍGUEZ
Attorney General
MARGARITA MERCADO
ECHEGARAY
Solicitor General
DEPARTMENT OF JUSTICE
COMMONWEALTH OF
PUERTO RICO
P.O. Box 9020192
San Juan, PR 00902

CHRISTOPHER LANDAU, P.C.
Counsel of Record
SUSAN M. DAVIES
CLAIRE MCCUSKER MURRAY
KIRKLAND & ELLIS LLP
655 Fifteenth St., N.W.
Washington, DC 20005
(202) 879-5000
clandau@kirkland.com

APPENDIX

APPENDIX CONTENTS

First Circuit opinion,
July 6, 2015 ..... 1a

District Court opinion,
February 6, 2015 ..... 69a

Recovery Act (Official English version) 138a

Pertinent statutory provisions 272a

United States Court of Appeals
For the First Circuit

Nos. 15-1218, 15-1221, 15-1271 & 15-1272

FRANKLIN CALIFORNIA TAX-FREE TRUST, *et al.*,
Plaintiffs, Appellees,
v.
COMMONWEALTH OF PUERTO RICO, *et al.*,
Defendants, Appellants,

PUERTO RICO ELECTRIC POWER AUTHORITY (PREPA),
Defendant.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO

[Hon. Francisco A. Besosa, *U.S. District Judge*]

Before

Howard, *Chief Judge*, Torruella and Lynch,
Circuit Judges.

Christopher Landau, with whom *Margarita Mercado-Echegaray*, Solicitor General for the Commonwealth of Puerto Rico, *Beth A. Williams*, *Michael A. Glick*, *Claire M. Murray*, and *Kirkland & Ellis LLP* were on brief, for the *Commonwealth of Puerto Rico*, *Governor Alejandro García-Padilla*, and *César R. Miranda-Rodríguez*, appellants.

Martin J. Bienenstock, with whom *John E. Roberts*, *Andrea G. Miller*, *Proskauer Rose LLP*, *Mark D. Harris*, *Sigal P. Mandelker*,

Philip M. Abelson, and *Ehud Barak* were on brief, for *Melba Acosta-Febo* and *John Doe*, appellants.

Lewis J. Liman, with whom *Jorge R. Roig*, *Joanne A. Tomasini-Muñiz*, *González, Machado & Roig, LLC*, *Lawrence B. Friedman*, *Richard J. Cooper*, *Sean A. O'Neal*, and *Cleary Gottlieb Steen & Hamilton LLP* were on brief, for the *Puerto Rico Electric Power Authority (PREPA)*, amicus curiae.

Gabriel R. Avilés-Aponte and *Tapia & Avilés* on brief for *Clayton P. Gillette* and *David A. Skeel, Jr.*, amici curiae.

Edilberto Berríos-Pérez and *Berríos & Longo Law Office, P.S.C.* on brief for *Edilberto Berríos-Pérez*, amicus curiae.

Matthew D. McGill, with whom *David C. Indiano*, *Jeffrey M. Williams* *Leticia Casalduc-Rabell*, *Indiano & Williams, PSC*, *Theodore B. Olson*, *Scott G. Stewart*, *Matthew J. Williams*, and *Gibson, Dunn & Crutcher LLP* were on brief, for *BlueMountain Capital Management, LLC*, appellee.

Thomas Moers Mayer, with whom *Kramer Levin Naftalis & Frankel LLP*, *Philip Bentley*, *David E. Blabey, Jr.*, *Toro, Colón, Mullet, Rivera & Sifre, P.S.C.*, *Manuel Fernández-Bared*, and *Linette Figueroa-Torres* were on brief, for *Franklin California Tax-Free Trust et al.*, appellees.

Marc E. Kasowitz, with whom *Daniel R. Benson*, *Hon. Joseph I. Lieberman* (ret.), *Hon. Clarine Nardi Riddle* (ret.), *Andrew K. Glenn*, and *Kasowitz, Benson, Torres & Friedman LLP* were on brief, for the *Association of Financial Guaranty Insurers*, amicus curiae.

Kate Comerford Todd, *Steven P. Lehotsky*, *U.S. Chamber Litigation Center, Inc.*, *William S. Consovoy*, *Thomas R. McCarthy*, *J. Michael Connolly*, and *Consovoy McCarthy PLLC* on brief for the *Chamber of Commerce of the United States of America*, amicus curiae.

July 6, 2015

LYNCH, *Circuit Judge.* The defendants, the Commonwealth of Puerto Rico, its Governor, its Secretary of Justice, and the Government Development Bank ("GDB"), assert that Puerto Rico is facing the most serious fiscal crisis in its history, and that its public utilities risk becoming insolvent. Puerto Rico, unlike states, may not authorize its municipalities, including these utilities, to seek federal bankruptcy relief under Chapter 9 of the U.S. Bankruptcy Code. 11 U.S.C. §§ 101(40), 101(52), 109(c). In June 2014, the Commonwealth attempted to allow its utilities to restructure their debt by enacting its own municipal bankruptcy law, the Puerto Rico Public Corporation Debt Enforcement and Recovery Act ("Recovery Act"), which expressly provides different protections for creditors than does the federal Chapter 9.

Plaintiffs are investors who collectively hold nearly two billion dollars of bonds issued by one of the distressed public utilities, the Puerto Rico Electric Power Authority ("PREPA"). Fearing that a PREPA filing under the Recovery Act was imminent, they brought suit in summer 2014 to challenge the Recovery Act's validity and enjoin its implementation. The district court found in their favor and permanently enjoined the Recovery Act on the ground that it is preempted under 11 U.S.C. § 903(1). *See Franklin Cal. Tax-Free Trust v. Puerto Rico*, __ F. Supp. 3d __, Nos. 14-1518, 14-1569, 2015 WL 522183, at *1, *12-18, *29 (D.P.R. Feb. 6, 2015); *Franklin Cal. Tax-Free Trust v. Puerto Rico*, No. 14-1518, 2015 WL 574008, at *1 (D.P.R. Feb. 10, 2015). That provision, § 903(1), ensures the uniformity of federal bankruptcy laws by prohibiting state municipal debt restructuring laws that bind creditors without their consent. 11 U.S.C. § 903(1); *see* S. Rep. No. 95-989, at 110 (1978).

The primary legal issue on appeal is whether § 903(1) preempts Puerto Rico's Recovery Act. That question turns on whether the definition of "State" in the federal Bankruptcy Code—as amended in 1984—renders § 903(1)'s preemptive effect inapplicable to Puerto Rico. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, sec. 421(j)(6), § 101(44), 98 Stat. 333, 368-39 (codified as amended at 11 U.S.C. § 101(52)). The post-1984 definition of "State" includes Puerto Rico, "*except*" for the purpose of "defining" a municipal debtor under § 109(c). 11 U.S.C. §§ 101(52), 109(c) (emphasis added). All parties agree that Puerto Rico now lacks the power it once had been granted by Congress to authorize its municipalities to file for Chapter 9 relief.

We hold that § 903(1) preempts the Recovery Act. The prohibition now codified at § 903(1) has applied to Puerto Rico since the predecessor of that section's enactment in 1946. The statute does not currently read, nor does anything about the 1984 amendment suggest, that Puerto Rico is outside the reach of § 903(1)'s prohibitions. *See Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998) ("We ... 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" (citation omitted)); *cf. Kellogg Brown & Root Servs. Inc. v. United States ex rel. Carter*, 135 S. Ct. 1970, 1977 (2015) ("Fundamental changes in the scope of a statute are not typically accomplished with so subtle a move."). Indeed, the Recovery Act would frustrate the precise purpose underlying the enactment of § 903(1). Accordingly, we *affirm*.

Defendants argue that this leaves Puerto Rico without relief. Although § 101(52) denies to Puerto

Rico the power to authorize its municipalities to pursue federal Chapter 9 relief, Puerto Rico may turn to Congress for recourse. Indeed, Congress preserved to itself that power to authorize Puerto Rican municipalities to seek Chapter 9 relief. Puerto Rico is presently seeking authorization or other relief directly from Congress. *See* Puerto Rico Chapter 9 Uniformity Act of 2015, H.R. 870, 114th Cong. (2015).

I.

Procedural History

Two groups of PREPA bondholders sued almost immediately following the Recovery Act's passage to prevent its enforcement. PREPA had issued their bonds pursuant to a trust agreement with the U.S. Bank National Association. The bondholders allege that the very enactment of the Recovery Act impaired these contractual obligations by abrogating certain protections that were promised in the event of default.[1] The first group, the Franklin plaintiffs,[2] filed on June

---

[1] *Compare, e.g.*, Puerto Rico Electric Power Authority Act ("Authority Act"), P.R. Laws Ann. tit. 22, § 207 (providing for a court-appointed receiver in event of default); Trust Agreement between PREPA & U.S. Bank National Association as Successor Trustee dated Jan. 1, 1974, as amended and supplemented through Aug. 1, 2011 ("Trust Agreement"), § 804 (permitting U.S. Bank National Association to seek court-appointed receiver pursuant to the Authority Act), *with* Recovery Act, § 108(b) ("This Act supersedes and annuls any insolvency or custodian provision included in the enabling or other act of any public corporation, including [Authority Act, P.R. Laws Ann. tit. 22, § 207] ....").

[2] We use "Franklin plaintiffs" to denote the plaintiffs who brought the first suit. The Franklin plaintiffs consist of two subsets of plaintiffs, referred to by the district court as the "Franklin plaintiffs" and the "Oppenheimer Rochester plaintiffs." The former are Delaware corporations or trusts that collectively

28, 2014, and cross-motioned for summary judgment on August 11, 2014. The second group, BlueMountain Capital Management, LLC ("BlueMountain"), for itself and on behalf of the funds it manages, filed on July 22, 2014. Together, the Franklin plaintiffs and BlueMountain hold nearly two billion dollars in PREPA bonds.

Both the Franklin plaintiffs and BlueMountain sought declaratory relief under 28 U.S.C. §§ 2201-02 that the Recovery Act is preempted by the federal Bankruptcy Code, violates the Contracts Clause, violates the Bankruptcy Clause, and unconstitutionally authorizes a stay of federal court proceedings. The Franklin plaintiffs (but not BlueMountain) also

---

hold about $692,855,000 of PREPA bonds. The latter are Delaware statutory trusts holding about $866,165,000 of PREPA bonds. For simplicity, we do not distinguish between these two subsets, but refer to both subsets collectively.

The individual parties who comprise the "Franklin plaintiffs" are: Franklin California Tax-Free Trust; Franklin New York Tax-Free Trust; Franklin Tax-Free Trust; Franklin Municipal Securities Trust; Franklin California Tax-Free Income Fund; Franklin New York Tax-Free Income Fund; Franklin Federal Tax-Free Income Fund; Oppenheimer Rochester Fund; Municipals Oppenheimer Municipal Fund; Oppenheimer Multi-State Municipal Trust; Oppenheimer Rochester Ohio Municipal Fund; Oppenheimer Rochester Arizona Municipal Fund; Oppenheimer Rochester Virginia Municipal Fund; Oppenheimer Rochester Maryland Municipal Fund; Oppenheimer Rochester Limited Term California Municipal Fund; Oppenheimer Rochester California Municipal Fund; Rochester Portfolio Series; Oppenheimer Rochester Amt-Free Municipal Fund; Oppenheimer Rochester Amt-Free New York Municipal Fund; Oppenheimer Rochester Michigan Municipal Fund; Oppenheimer Rochester Massachusetts Municipal Fund; Oppenheimer Rochester North Carolina Municipal Fund; and Oppenheimer Rochester Minnesota Municipal Fund.

brought a Takings Claim under the Fifth and Fourteenth Amendments. And BlueMountain (but not the Franklin plaintiffs) brought a claim under the contracts clause of the Puerto Rico constitution. These claims were brought against the Commonwealth of Puerto Rico, Governor Alejandro García-Padilla, and various Commonwealth officials, including GDB agents.[3] The district court consolidated the cases and aligned the briefing on August 20, 2014, but did not merge the suits.

The district court issued an order and opinion in both cases on February 6, 2015, resolving the motions to dismiss and the Franklin plaintiffs' outstanding cross-motion for summary judgment. *Franklin Cal. Tax-Free Trust*, __ F. Supp. 3d __, 2015 WL 522183, at *1. It entered judgment in the *Franklin* case on February 10, 2015. *Franklin Cal. Tax-Free Trust*, 2015 WL 574008, at *1.

As relevant here, the district court held that the Recovery Act was preempted by federal law and permanently enjoined its enforcement. It also denied

---

[3] The Franklin plaintiffs and BlueMountain named different Commonwealth defendants. Both sued the Governor and agents of the GDB. But only the Franklin plaintiffs (not BlueMountain) sued the Commonwealth itself, while BlueMountain (not the Franklin plaintiffs) named Puerto Rico's Secretary of Justice, César Miranda-Rodríguez, as a defendant.

The Franklin plaintiffs (not BlueMountain) had also sued PREPA itself, but those claims were dismissed for lack of standing.

the motion to dismiss the Contracts Clause claim and one of the Franklin plaintiffs' Takings claims.[4]

The Commonwealth defendants appeal from the permanent injunction, the grant of summary judgment to the Franklin plaintiffs, and further argue that the district court erred by reaching the Contracts Clause and Takings Claims in its February 6 order.

II.

Because the appeal presents a narrow legal issue, we summarize only those facts as are necessary. We do not address in any detail the extent of the fiscal crisis facing the Commonwealth, PREPA, or other Commonwealth entities. We begin with the considerations shaping the state-authorization requirement of § 109(c)(2), the provision that presently, in combination with § 101(52), bars Puerto Rico from authorizing its municipalities to bring claims for federal Chapter 9 relief.

A. *The History of Federal Municipal Bankruptcy Relief, and the State-Authorization Requirement*

Modern municipal bankruptcy relief is shaped by two features: the difficulties inherent in enforcing payment of municipal debt, and the historic understanding of constitutional limits on fashioning relief. M.W. McConnell & R.C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 426-28 (1993). The difficulties arise because municipalities are government entities, and so the methods for addressing their insolvency are limited in ways that

---

[4] The district court dismissed without prejudice the remaining claims for lack of ripeness, and all claims asserted against PREPA for lack of standing.

the methods for addressing individual or corporate insolvency are not.[5] *Id.* at 426-50; *see also* 11 U.S.C. § 101(40) (defining "municipality" as "political subdivision[s]," "public agenc[ies]," and other "instrumentalit[ies] of a State"). Navigating these difficulties is further complicated, for state municipalities, by a two-prong dilemma created by the Contracts Clause and the Tenth Amendment. *See* McConnell & Picker, 60 U. Chi. L. Rev. at 427-28.

For these reasons, municipalities remained completely outside any bankruptcy regime for much of the nation's history. *See id.* at 427-28. Indeed, the prevailing assumption was that the constitutional limitations precluded either level of government, state or federal, from enacting a municipal bankruptcy regime. *See id.* States could not provide an effective solution to the "holdout problem" presented by insolvency because doing so "would [require] impair[ing] the obligation of contracts" in violation of

---

[5] For example, remedies traditionally available in bankruptcy, like seizing assets, corporate reorganization, liquidation, or judicial oversight of the debtor's day-to-day affairs, are traditionally unavailable in enforcing the payment of municipal debt. *See* McConnell & Picker, 60 U. Chi. L. Rev. at 426-50; *see also City of East St. Louis v. United States ex rel. Zebley*, 110 U.S. 321, 324 (1884) ("[W]hat expenditures are proper and necessary for the municipal administration, is not judicial; it is confided by law to the discretion of the municipal authorities. No court has the right to control that discretion, much less to usurp and supersede it."). The relative unavailability of these "bitter medicine[s]" makes it more difficult for municipal bankruptcy regimes to navigate the gauntlet between addressing the "holdout" problem that bankruptcy is designed to resolve, and limiting the "moral hazard" problem that is exacerbated by the availability of bankruptcy relief. McConnell & Picker, 60 U. Chi. L. Rev. at 426-27, 494-95.

the Contracts Clause.[6] *See id.* at 426-28. Federal intervention, on the other hand, might interfere with states' rights under the Tenth Amendment in controlling their own municipalities. *Id.* at 427-28; *see also Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 530-32 (1936) (striking down the first federal municipal bankruptcy law on federalism grounds).

The problems created by this absence of municipal bankruptcy relief became acute during the Great Depression. And so, in 1933, Congress enacted Chapter 9's predecessor to provide to states a mechanism for addressing municipal insolvency that they could not create themselves. *See* McConnell &

---

[6] The holdout problem occurs in restructuring negotiations because creditors who refuse to capitulate early can often secure more favorable terms by "holding out." *See, e.g.*, McConnell & Picker, 60 U. Chi. L. Rev. at 449-50. Municipal bankruptcy relief can ameliorate this problem by binding the dissenters—the holdouts—provided a large enough class of creditors agrees. *See generally* McConnell & Picker, 60 U. Chi. L. Rev. 425. Indeed, some have suggested that even the shadow of the law in this area can assist negotiations, and that its absence can hinder it. *See, e.g.*, D.A. Skeel, Jr., *States of Bankruptcy*, 79 U. Chi. L. Rev. 677, 689-90 (2012) (suggesting that "a bankruptcy law could prove beneficial *even if it is never used*"). *Compare id.* at 720 & nn. 191 & 192 (discussing a series of studies concerning the effect on debt price of a bankruptcy alternative to the holdout problem, so-called "collective-action clauses" (citing, *e.g.*, S.J. Choi, M. Gulati, & E.A. Posner, *Pricing Terms in Sovereign Debt Contracts: A Greek Case Study with Implications for the European Crisis Resolution Mechanism* *10-11 (U. Chi. John M. Olin L. & Econ. Working Paper No. 541, Feb. 1, 2011))), *with Municipal Bankruptcy—Preemption—Puerto Rico Passes New Municipal Reorganization Act*, 128 Harv. L. Rev. 1320, 1327 (2015) (suggesting that the Recovery Act forced creditors to the negotiation table).

Picker, 60 U. Chi. L. Rev. at 427-29, 450-54 (summarizing the history).

Although it had a rocky start, *see, e.g.*, *Ashton*, 298 U.S. at 530-32 (invalidating the initial act), Congress eventually succeeded in avoiding a Tenth Amendment problem. It did so in part by requiring a state's consent in the federal municipal bankruptcy regime before permitting municipalities of that state to seek relief under it, and in part by emphasizing that the statute did not effect "'any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties.'" *See, e.g.*, *United States v. Bekins*, 304 U.S. 27, 49-54 (1938) (quoting H.R. Rep. No. 75-517, at 2 (1937); S. Rep. No. 75-911, at 2 (1937)) (recognizing that this created a "cooperati[ve]" scheme); *cf.* McConnell & Picker, 60 U. Chi. L. Rev. at 452-53. This is the origin of the state-authorization requirement of § 109(c).[7] That provision of the Code provides that a municipality may be a debtor under Chapter 9 only if it "is specifically authorized ... to be a debtor under such chapter by State law, or by a governmental officer or organization

---

[7] This is the historical gloss given by courts and commentators alike because the *Bekins* Court declined to follow *Ashton* but without expressly overruling it. *See Bekins*, 304 U.S. at 49-54; *see, e.g.*, *In re Jefferson Cnty., Ala.*, 469 B.R. 92, 99 (N.D. Ala. 2012); McConnell & Picker, 60 U. Chi. L. Rev. at 452-53. A similar state-authorization requirement had been present in the original municipal bankruptcy act that the Court struck down in *Ashton*, but the *Bekins* Court recognized that state consent alleviates a potential "constitutional obstacle ... in the right of the State to prevent a municipality from seeking bankruptcy protection," and makes the federal scheme a cooperative endeavor. *See* McConnell & Picker, 60 U. Chi. L. Rev. at 452-53 (discussing the cases and changes to the Act made in the interim between them); *see also Bekins*, 304 U.S. at 49-54.

empowered by State law to [so] authorize." 11 U.S.C. § 109(c)(2).

This requirement of state consent is based on reason: a state might instead decide to bail out an ailing municipality, if its own fiscal situation permits, to avoid the negative impact that a municipal bankruptcy would have on that state's economy and other municipalities. *See* C.P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. Chi. L. Rev. 281, 302-08 (2012) (explaining the problem of "debt contagion"). But allowing state municipalities to bypass the state and seek federal Chapter 9 relief would undermine a state's ability to do so. *See id.* at 285-86. In this way, the state-authorization requirement not only addresses constitutional difficulties by making Chapter 9 a "cooperati[ve]" state-federal scheme, *Bekins*, 304 U.S. at 49-54, it also promotes state sovereignty by preventing municipalities from strategically seeking (or threatening to seek) federal municipal relief to "reduce the conditions that states place on a proposed bailout," Gillette, 79 U. Chi. L. Rev. at 285-86.

B. *Puerto Rico Municipalities Under the Code: 1938-1984*

Puerto Rico was granted the authority to issue bonds, and to authorize its municipalities to issue bonds, in 1917.[8] *See* Act of Mar. 2, 1917, ch. 145, § 3,

---

[8] The authorizing act also created Puerto Rico's "triple tax-exempt" status by prohibiting federal, state, and local taxation of Puerto Rico's municipal bonds. *See* Act of Mar. 2, 1917, ch. 145, § 3, 39 Stat. at 953 (codified as amended at 48 U.S.C. § 745). This provision has not been amended since 1961, when limits on the amount of municipal debt that could be issued (as a percentage of the municipalities' property valuation) were removed, subject to

39 Stat. 951, 953 (codified as amended at 48 U.S.C. § 741). Like municipalities of a state, a municipality in Puerto Rico is excluded from bankruptcy relief under the Code's other chapters if it becomes unable to meet these bond obligations. *See, e.g.*, 11 U.S.C. § 109; *cf.* McConnell & Picker, 60 U. Chi. L. Rev. at 426-50 (explaining the obstacles to treating municipal insolvency like corporate insolvency). And, at least from 1938 until the modern Bankruptcy Code was introduced in 1978, Puerto Rico, like the states, could authorize its municipalities to obtain federal municipal bankruptcy relief.[9] *See* 11 U.S.C. §§ 1(29), 403(e)(6)

---

approval by a vote in the Commonwealth. *See* Joint Resolution of Aug. 3, 1961, Pub. L. No. 87-121, sec. 1, § 3, 75 Stat. 245.

But Puerto Rico's status in thus respect is not entirely remarkable. State and local bonds have enjoyed federal tax-exempt status "since the modern income tax system was enacted in 1913." Nat'l Assoc. of Bond Lawyers, *Tax-Exempt Bonds: Their Importance to the National Economy and to State and Local Governments* 5 (Sept. 2012) ("*Tax-Exempt Bonds*"); *see also* 26 U.S.C. § 103. The main difference is that states and local governments may not tax Puerto Rico municipal bonds, though they may tax their own or other states' municipal bonds. *See* T. Chin, *Puerto Rico's Possible Statehood Could Affect Triple Tax-Exempt Status*, 121 The Bond Buyer No. 213 (Nov. 5, 2012); *see also Tax-Exempt Bonds*, *supra*, at 5 (explaining that, until 1988, "the tax-exempt status of interest on state and local government bonds also was believed to be constitutionally protected under the doctrine of intergovernmental immunities"); *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 583-86 (1895), *modified*, 158 U.S. 601 (1895), *overruled in part by* U.S. Const, amend. XVI, *South Carolina v. Baker*, 485 U.S. 505, 515-27 (1988).

[9] From 1938 until the modern Code's enactment, state authorization was required for plan confirmation. *See* Act of Aug. 16, 1937, Pub. L. No. 302, ch. 657, sec. 83(e) (6), 50 Stat. 653, 658 (codified at 11 U.S.C. § 403(e)(6) (1937) (conditioning confirmation of a plan on, *inter alia*, petitioner being "authorized by law to take all action necessary to be taken by it to carry out the plan"));

(1938); 48 U.S.C. § 734 (1934); *Bekins*, 304 U.S. at 49; *accord* 11 U.S.C. §§ 1(29), 404 (1976); 48 U.S.C. § 734 (1976); *see also* S.J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 572 (2014). And although the modern Code omitted a definition of the term "State" from its enactment in 1978 until it was re-introduced in 1984, most commentators agree that this did not affect Puerto Rico's ability during that time to provide its municipalities authorization.[10] *See, e.g.*, Lubben, 88

Bekins, 304 U.S. at 49 (holding that "law" in § 403(e)(6) refers to "state" law); *accord* 11 U.S.C. § 404 (1976). Puerto Rico's power to provide this authorization to its municipalities follows from two other statutory provisions: the Bankruptcy Act's definition of "State," in effect from 1938 to 1978, which defined "State" to include "the Territories and possessions to which this Act is or may hereafter be applicable," Act of June 22, 1938, Pub. L. No. 696, ch. 575, § 1(29), 52 Stat. 840, 842 (codified at 11 U.S.C. § 1(29) (1938)); *accord* 11 U.S.C. § 1(29) (1976); and the extension of United States laws to Puerto Rico "except as ... otherwise provided," in effect from 1917 to the present, 48 U.S.C. § 734. *See also* S.J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 572 (2014).

[10] The omission of a definition of "State" from the modern Bankruptcy Code was recognized as an error almost as soon as the modern Code was enacted. *See* Lubben, 88 Am. Bankr. L.J. at 573-75. Most assumed that the Code would still apply to Puerto Rico because, despite the significant substantive and procedural changes that the Code made to pre-Code law, those changes were tangential to the continued applicability of the federal bankruptcy law to Puerto Rico. *See, e.g.*, *id.* at 572-73 & n.125; *see also In re Segarra*, 14 B.R. 870, 872-73 (D.P.R. 1981) (finding nothing that "would indicate that anyone in the vast bureaucracy of the federal government has had the slightest doubt that Congress did not intend the Bankruptcy Code to extend to Puerto Rico"); *cf. Cohen*, 523 U.S. at 221-22 (explaining that the Code is not to be construed "to erode past bankruptcy practice absent a clear indication that Congress intended such a departure"); *Wellness Int'l Network, Ltd.*

Am. Bankr. L.J. at 572-73 & n.125; An Act to Establish a Uniform Law on the Subject of Bankruptcies ("Bankruptcy Reform Act of 1978"), Pub. L. No. 95-598, 92 Stat. 2549 (1978)(codified as amended at 11 U.S.C. §§ 101 *et seq.*); *see also Cohen*, 523 U.S. at 221-22; *In re Seaarra*, 14 B.R. 870, 872-73 (D.P.R. 1981).

This changed in 1984, when Congress re-introduced a definition of "State" to the Code.[11] Bankruptcy Amendments and Federal Judgeship Act of 1984, sec.

---

v. Sharif, 135 S. Ct. 1932, 1939 (2015) (describing the Code's expansion of power given to courts adjudicating bankruptcy cases).

Even so, this omission and others in the Code's early years led to at least some ambiguity about the Code's applicability to Puerto Rico. *See* Lubben, 88 Am. Bankr. L.J. at 572-73 & n.125 (explaining this was because both the definition of "State" and that of "United States" were absent in the original 1978 Code); *see also In re Segarra*, 14 B.R. at 872-73 (holding that the Code applied to Puerto Rico under 48 U.S.C. § 734). In addition to the general ambiguity about the applicability of the Code, in its entirety, to Puerto Rico, the applicability of Chapter 9 relief in particular was "further confused" by the inclusion of a definition for "governmental unit" that referenced both "State" and "Commonwealth" separately. Lubben, 88 Am. Bankr. L.J. at 572-73 n.125; An Act to Establish a Uniform Law on the Subject of Bankruptcies ("Bankruptcy Reform Act of 1978"), Pub. L. No. 95-598, § 101(21), 92 Stat. 2549, 2552 (1978) (codified as amended at 11 U.S.C. § 101 (27)).

[11] Correcting the Code's omission of this definition was one of many changes made. Indeed, the primary purpose of the Act was entirely unrelated: Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984 in large part to "respond[]" to the Court's decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), which had held parts of the Code's new system of bankruptcy courts and expanded bankruptcy jurisdiction to be unconstitutional. *See Wellness Int'l Network, Ltd.*, 135 S. Ct. at 1939.

421(j)(6), § 101(44), 98 Stat. at 368-69 (codified as amended at 11 U.S.C. § 101(52)). This 1984 amendment is key to this case. Like previous definitions, § 101(52) defines "State" to "include[] ... Puerto Rico." But importantly, and unlike previous versions of the definition, the re-introduced definition of "State" includes Puerto Rico "*except* for the purpose of defining who may be a debtor under chapter 9 of [the Bankruptcy Code]."[12] 11 U.S.C. § 101(52) (emphasis added). *Compare id.*, *with* Act of June 22, 1938, Pub. L. No. 696, ch. 575, § 1(29), 52 Stat. 840, 842. As a result of this exception, Puerto Rico municipalities became expressly (though indirectly) forbidden from filing under Chapter 9 absent further congressional

---

[12] The new version, unlike previous versions, also excludes the District of Columbia from the definition of "State" for purposes of defining Chapter 9 debtors. *Compare* 11 U.S.C. § 101(52), *with* Act of June 22, 1938, Pub. L. No. 696, ch. 575, § 1(29), 52 Stat. 840, 842.

And, unlike the previous version, the other territories are not expressly included for any purpose. 11 U.S.C. § 101(52). Only two definitions in § 101 refer to "territories": subsection (27), defining "governmental unit," and subsection (55), defining the geographical scope of the "United States." *See* 11 U.S.C. § 101(27) ("The term 'governmental unit' means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States ..., a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government."); 11 U.S.C. § 101(55) ("The term 'United States', when used in a geographical sense, includes all locations where the judicial jurisdiction of the United States extends, including territories and possessions of the United States."); *cf.* 11 U.S.C. § 109(a) ("Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.").

action: the change deprived Puerto Rico of the power to grant its municipalities the authorization required by § 109(c)(2) to file for Chapter 9 relief. *See* 11 U.S.C. § 109(c) (defining who may be a Chapter 9 debtor). The two sides to this controversy dispute whether this change was also meant to transform the preemption provision of § 903(1) without Congress expressly saying so.

C. *The Recovery Act: Puerto Rico's Stated Attempt to "Fill the Gap"*

Facing a fiscal crisis and lacking the power to authorize its municipalities to seek Chapter 9 relief, the Commonwealth enacted the Recovery Act in June 2014, to take effect immediately. Somewhat modeled after Chapter 9, but with significant differences, the Recovery Act "establish[ed] a debt enforcement, recovery, and restructuring regime for the public corporations and other instrumentalities of the Commonwealth of Puerto Rico during an economic emergency." Recovery Act, Preamble (translation provided by the parties); *id.*, Stmt. of Motives, § E. In particular, the Act was intended to ameliorate the fiscal situations of several distressed Puerto Rican public corporations whose combined deficit in 2013 totaled $800 million, and whose combined debt reaches $20 billion: PREPA, the Aqueduct and Sewer Authority ("PRASA"), and the Highways and Transportation Authority ("PRHTA"). *Id.*, Stmt. of Motives, § A.

The Recovery Act provides two methods for restructuring debt: Chapter 2 "Consensual Debt Relief," and Chapter 3 "Debt Enforcement." *Id.*, Preamble. Although defendants say these serve as a substitute for Chapter 9, both Chapter 2 and Chapter 3 relief under the Recovery Act appear to provide less

protection for creditors than the federal Chapter 9 counterpart. *See* L.S. McGowen, *Puerto Rico Adopts a Debt Recovery Act for Its Public Corporations*, 10 Pratt's J. Bankr. L. 453, 460-62 (2014). This is one form of harm that plaintiffs say the Recovery Act has caused them.

For example, Chapter 2 relief under the Recovery Act purports to offer a "consensual debt modification procedure" leading to a recovery plan that would only become binding "with the consent of a supermajority" of creditors. Recovery Act, Stmt. of Motives, § E. But this is belied by the provisions: Chapter 2 permits a binding modification, including debt reduction, to a class of debt instruments with the assent of creditors holding just over one-third of the affected debt.[13] *Id.* § 202(d)(2); *see also id.* Stmt. of Motives, § E. There is no analogous "consensual procedure" under federal law.

Chapter 3 relief, on the other hand, is a court-supervised process designed to mirror, in some ways, Chapter 9 and Chapter 11 of the federal Code. *Id.*, Stmt. of Motives, § E. But while Chapter 3 debtors, like federal Chapter 9 debtors, may avoid certain contractual claims, protections for creditors are again reduced. *Compare, e.g.*, *id.* §§ 325, 326, *with* 11 U.S.C. §§ 365(e), 901(a); *see also* McGowen, 10 Pratt's J. Bankr. L. at 461. For example, unlike in the federal Code, the Recovery Act does not provide a "safe harbor"

---

[13] Specifically, a proposed modification becomes binding on all creditors within a class of affected debt instruments if (1) creditors of at least 50% of the amount of debt in that class participate in a vote or consent solicitation; and (2) creditors of at least 75% of the amount of debt that participates in the vote or consent solicitation approves the proposed modifications. Recovery Act, § 202(d)(2).

for derivative contracts. *Compare* Recovery Act, § 325(a), *with* 11 U.S.C. § 365(e); *see also* Recovery Act, § 205(c); McGowen, 10 Pratt's J. Bankr. L. at 461.

Municipalities that the Commonwealth may not authorize for federal Chapter 9 relief are nonetheless purportedly made eligible by the Recovery Act to seek both Chapter 2 and 3 relief, either simultaneously or sequentially, with approval from the GDB. Recovery Act, §§ 112, 201(b), 301(a). Unlike the federal Code, the Recovery Act also expressly permits the Governor to institute an involuntary proceeding if the GDB determines that doing so is in the best interest of both the distressed entity and the Commonwealth."[14] Recovery Act, §§ 201(b)(2), 301(a)(2).

Plaintiffs argue that the very enactment of these and other provisions cause them harm in several ways: by denying them the protection for which they bargained under the Trust Agreement, by denying them the protection to which they would be entitled under federal relief, and by injecting uncertainty into the bond market that reduces their bargaining position to address pending default. *See* McGowen, 10 Pratt's

---

[14] The federal Code does not permit involuntary Chapter 9 proceedings brought by creditors, *see* 11 U.S.C. § 303(a) (limiting involuntary petitions to cases under Chapter 7 or 11), and does not expressly address whether states may institute these quasi-involuntary proceedings on behalf of their municipalities. At least one commentator has suggested that states are prohibited from doing so by § 109(c)(4), which requires that a potential municipal debtor "desire[] to effect a plan to adjust such debts." *See* Gillette, 79 U. Chi. L. Rev. at 297.

By contrast, the Recovery Act similarly precludes involuntary proceedings brought by creditors, Recovery Act, § 301(c), but expressly allows these quasi-involuntary proceedings to be initiated by the government, *see id.* § 301(a)(2).

J. Bankr. L. at 460-61 (discussing other examples, including the lack of protection for holders of liens on revenue should the municipality need to obtain credit to perform public functions).

III.

A. *Jurisdiction*

We have appellate jurisdiction over the final judgment granting summary judgment and issuing a permanent injunction in favor of the Franklin plaintiffs under 28 U.S.C. § 1291. We have appellate jurisdiction over the injunction issued in favor of BlueMountain under 28 U.S.C. § 1292(a)(1).[15] Because we affirm the preemption ruling and attendant injunction, we decline to exercise jurisdiction over defendants' appeal of the district court's February 6, 2015 order denying the motions to dismiss the surviving Contracts Clause and Takings Claims. *Cf. First Med. Health Plan, Inc. v. Vega-Ramos*, 479 F.3d 46, 50 (1st Cir. 2007) (discussing an exception to the general rule that denials of 12(b)(6) motions to dismiss are interlocutory rulings outside the scope of appellate jurisdiction).[16]

---

[15] This difference is an odd quirk of the procedure below: BlueMountain never moved for summary judgment, and so there is no final judgment from which to appeal, only the injunction from the order dated February 6, 2015.

[16] The defendants challenged the ripeness of the relevant claims before the district court, but not on appeal. "[A]lthough [they] do not press this issue on appeal, it concerns our jurisdiction under Article III, so we must consider the question on our own initiative." *Metro. Wash. Airports Auth. v. Citizens for the Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 265 n.13 (1991) (citing *Liberty Mut. Ins. Co. v. Wetzel*, 424 U.S. 737, 740 (1976)).

B. *Preemption under § 903(1)*

Puerto Rico may not enact its own municipal bankruptcy laws to cover the purported gap created by the 1984 amendment if such laws are preempted by the federal Bankruptcy Code. U.S. Const, art. VI, cl. 2; *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 663 (1993). Thus, the issue on this appeal is whether 11 U.S.C. § 903(1) preempts Puerto Rico from enacting its

---

We conclude that the defendants were correct in conceding ripeness: The plaintiffs allege that the Recovery Act itself impairs the terms of the agreements governing the PREPA bonds. *Compare, e.g.*, Authority Act, P.R. Laws Ann. tit. 22, § 207 (providing for a court-appointed receiver in event of default); Trust Agreement, § 804 (permitting U.S. Bank National Association to seek court-appointed receiver pursuant to the Authority Act), *with* Recovery Act, § 108(b) ("This Act supersedes and annuls any insolvency or custodian provision included in the enabling or other act of any public corporation, including [Authority Act, P.R. Laws Ann. tit. 22, § 207]...."). That is, plaintiffs allege that the very enactment of the Recovery Act, rather than the *manner* of enforcement, impairs their contractual rights—allegations that present purely legal issues or factual issues controlled by past events. Accordingly, the outcome of the case cannot be affected by subsequent events (except to be mooted), and so these issues satisfy the "fitness" prong of our ripeness inquiry. *See Roman Catholic Bishop of Springfield v. City of Springfield*, 724 F.3d 78, 89-93 (1st Cir. 2013). And because "the sought-after declaration" on the surviving Contracts Clause and preemption claims "would be of practical assistance in setting the underlying controversy to rest," a refusal to grant relief would result in hardship to the parties. *See Rhode Island v. Narragansett Indian Tribe*, 19 F.3d 685, 693 (1st Cir. 1994). This claim is ripe for review. *See Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11, 16-17 (1st Cir. 2014) ("Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." (quoting *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007)) (internal quotation marks omitted)).

own municipal bankruptcy law. Our answer to that question is largely driven by examining whether the 1984 amendment adding § 101(52) altered § 903(1)'s effect. *See Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" (quoting *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515, 521 (1943))); *CSX Transp.*, 507 U.S. at 663-64 ("Where a state statute conflicts with, or frustrates, federal law, the former must give way."). Our review is de novo. *Mass. Delivery Ass'n v. Coakley*, 769 F.3d 11, 17 (1st Cir. 2014) (citing *DiFiore v. Am. Airlines, Inc.*, 646 F.3d 81, 85 (1st Cir. 2011)).

Whether a federal law preempts a state law "is a question of congressional intent." *Hawaiian Airlines, Inc. v. Norris*, 512 U.S. 246, 252 (1994). We begin with the statutory language, which often "contains the best evidence of Congress' pre-emptive intent." *Mass. Delivery Ass'n*, 769 F.3d at 17 (quoting *Dan's City Used Cars, Inc. v. Pelkey*, 133 S. Ct. 1769, 1778 (2013)) (internal quotation marks omitted). We also consider "the clause's purpose, history, and the surrounding statutory scheme." *Id.*

The relevant provision, § 903(1), states in full: "a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition." 11 U.S.C. § 903(1).[17] This provision, by its plain language, bars a state law like the Recovery Act.

---

[17] This provision appears in § 903, which reads in full:

> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such

There is no disputing that the Recovery Act is a "law prescribing a method of composition of indebtedness" of eligible Puerto Rico municipalities that may "bind" said municipalities' creditors without those creditors' "consent." And, because "State" is defined to include Puerto Rico under § 101(52), the Recovery Act is a "State law" that does so. But this, under § 903(1), Puerto Rico "may not" do, and so we hold that the Recovery Act is preempted. *Compare* 11 U.S.C. § 903(1) ("[A] State law ... *may not* bind any creditor that does not consent...." (emphasis added)), *with* 49 U.S.C. § 14501(c)(1) ("[A] State ... *may not* enact or enforce a law ... related to a price, route, or service...." (emphasis added)); *Dan's City*, 133 S. Ct. at 1778 (noting that this language in § 14501(c)(1) "prohibits enforcement of state laws 'related to a price, route or service....'").

The context and history of this provision confirm this construction—that this provision was intended to have a preemptive effect. *Cf. Dan's City*, 133 S. Ct. at 1778; *Cohen*, 523 U.S. at 221. Context and history also confirm that our construction is consistent with the previous constructions of this provision, and so, absent clear congressional intention to modify the bankruptcy law, we "will not read the Bankruptcy Code to erode

---

municipality, including expenditures for such exercise, but—

(1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and

(2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

past bankruptcy practice." *Cohen*, 523 U.S. at 221 (citation and internal quotation marks omitted); *see also Dewsnup*, 502 U.S. at 419 ("When Congress amends the bankruptcy laws, it does not write 'on a clean slate.'" (quoting *Emil*, 318 U.S. at 521)).

The Code, at § 903(1), "is derived, with stylistic changes, from" its precursor, Section 83(i). S. Rep. No. 95-989 at 110. The legislative history reveals, and the parties do not dispute, that the purpose of Section 83(i) was to overrule an early Supreme Court decision which had upheld a state law permitting the adjustment of municipal debt if the city and 85% of creditors agreed. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 504, 513-16 (1942).[18] Before *Faitoute*, most had assumed that states could not themselves address the holdout problem that municipal bankruptcy relief is designed to resolve because they were barred from adjusting debt obligations (without all creditors' consent) under the Contracts Clause. *See* McConnell & Picker, 60 U. Chi. L. Rev. at 452-54.

Congress enacted Section 83(i) to restore what had been believed to be the pre-*Faitoute* status quo by expressly prohibiting state municipal bankruptcy laws adjusting creditors' debts without their consent.[19] *See*,

---

[18] The GDB defendants, at oral argument, presented a strained reading of the manner in which Section 83(i) overruled *Faitoute*. They argued that the sole purpose of Congress in overruling *Faitoute* was to allow municipalities to convert to federal proceedings those state municipal bankruptcy proceedings that, like the one in *Faitoute*, had arisen in the absence of a federal municipal bankruptcy regime from 1933-1937. We do not share this limited reading of *Faitoute*, which also does not comport with either the legislative history or the scholarship on the subject.

[19] The full text of Section 83(i) as enacted in 1946 reads:

e.g., H.R. Rep. No. 79-2246, at 4 (1946) ("State adjustment acts have been held to be valid, but ... *[o]nly under a Federal law* should a creditor be forced to accept such an adjustment without his consent." (emphasis added)). And Congress sought to preserve Section 83(i) when it re-codified the section as § 903(1) in 1978. *See* S. Rep. No. 95-989 at 110 (noting that this was necessary to maintain the uniformity of the bankruptcy laws by preventing states from enact[ing] their own versions of Chapter IX'" (quoting L.P. King, *Municipal Insolvency: Chapter IX. Old and New; Chapter IX Rules*, 50 Am. Bankr. L.J. 55, 65 (1976))); *cf. Kellogg*, 135 S. Ct. at 1977 (explaining that retention of language indicates absence of alteration).[20]

> Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State ... *Provided, however*, That no State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition, and no judgment shall be entered under such State law which would bind a creditor to such composition without his consent.

Act of July 1, 1946, Pub. L. No. 481, ch. 532, sec. 83(i), 60 Stat. 409, 415.

[20] The Senate notes concerning the enactment of § 903 explain in relevant part:

> Section 903 is derived, with stylistic changes, from section 83 of current Chapter IX. It sets forth the primary authority of a State, through its constitution, laws, and other powers, over its municipalities. The proviso in section 83, prohibiting State composition procedures for municipalities, is retained. Deletion of the provision would "permit all States to enact their own versions of Chapter IX", *Municipal Insolvency*, 50 Am. Bankr. L.J. 55, 65, which would frustrate the

These provisions on their face barred Puerto Rico and the Territories, just as they did the states, from enacting their own versions of Chapter 9 creditor debt adjustment. From the time of its enactment in 1946, Section 83(i)'s prohibition on "State law[s] prescribing a method of composition of indebtedness" expressly applied to Puerto Rico law because "State" had been defined to include the "Territories and possessions," like Puerto Rico, to which the Bankruptcy Act was applicable. *See* Act of June 22, 1938, Pub. L. No. 696, ch. 575, § 1(29), 52 Stat, at 842 (defining "States"); Act of July 1, 1946, Pub. L. No. 401, ch. 532, sec. 83(i), 60 Stat. 409, 415 (prohibiting "State law[s] prescribing a method of composition of indebtedness"); Act of Mar. 2, 1917, ch. 145, § 9, 39 Stat. 951, 954 (codified as amended at 48 U.S.C. § 734) ("[T]he statutory laws of the United States not locally inapplicable, except as ... otherwise provided, shall have the same force and effect in Porto Rico as in the United States....").

The re-codification of this provision, § 903(1), must continue to apply to Puerto Rico because there is no evidence of express modification by Congress. *See Dewsnup*, 502 U.S. at 419-20. The mere absence of a definition of "state" in the Code from 1978 until the 1984 amendment does not provide such evidence, nor does the legislative history.[21] *Cf. id.* "Fundamental

---

constitutional mandate of uniform bankruptcy laws. *Constitution of the United States*. Art. I, Sec. 8.

S. Rep. No. 95-989 at 110.

[21] If anything, the legislative history suggests that the missing definition was a mistake, and so no alteration of § 903(1)'s or the rest of the Code's applicability to Puerto Rico was intended. *See* Lubben, 88 Am. Bankr. L.J. at 573 (explaining that adding a definition of "State" was among the proposed 1979 amendments "to 'clean up' errors in the original 1978 Code").

changes in the scope of a statute are not typically accomplished with so subtle a move." *Kellogg*, 135 S. Ct. at 1977 (declining to find a significant change to a statute based on the removal of a small phrase while retaining the operative language).

There is little doubt that § 903(1) would have pre-empted the Recovery Act, save for the questions occasioned by the 1984 amendment at issue. There is no disputing that the Recovery Act was a "State law" under Section 83(i), and so too under § 903(1) from 1978-1984. And there is no disputing that the Recovery Act binds creditors without their consent or that it is Puerto Rico's "own version[] of Chapter [9]," such that it directly conflicts with § 903(1)'s prohibition of such laws.[22] S. Rep. No. 95-989 at 110; Recovery Act, Stmt. of Motives, § E; *see CSX Transp., Inc.*, 507 U.S. at 663 ("Where a state statute conflicts with ... federal law, the former must give way.").

The question is whether the preemption provision of § 903(1) still applies in the face of the 1984 amendment. We hold that it does. The addition of the definition of "State" in 1984 does not, by its text or its history, change the applicability of § 903(1) to Puerto Rico.[23] 11 U.S.C. § 101(52). To the contrary, because

---

[22] For this reason, we need not address the exact scope of this preemption under either Section 83(i) or § 903(1). *Cf. Dan's City*, 133 S. Ct. at 1778 (noting that when "Congress has superseded state legislation by statute," the only task remaining is to "identify the domain expressly pre-empted" (quoting *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541 (2001)) (internal quotation marks omitted)).

[23] The parties agree that there is nothing in the legislative history directly indicating a change to § 903(1), only a change to § 109(c). Amici bankruptcy law experts, Clayton Gillette and David Skeel, Jr., inform us that "almost the only reference to the

§ 903(1) does not define who may be a debtor under Chapter 9, § 101(52) confirms that the "State law[s]" prohibited include those of Puerto Rico, as has always been the case. *Cf. Dewsnup*, 502 U.S. at 419 ("[T]his Court has been reluctant to accept arguments that would interpret the Code ... to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history."); *Kellogg*, 135 S. Ct. at 1977 ("The retention of the same term in the later laws suggests that no fundamental alteration was intended."). If Congress had wanted to alter the applicability of § 903(1) to Puerto Rico, it "easily could have written" § 101(52) to exclude Puerto Rico laws from the prohibition of § 903(1), just as it had excluded Puerto Rico from the definition of debtor under § 109(c). *See Burgess v. United States*, 553 U.S. 124, 130 (2008). But Congress did not.

The legislative history is silent as to the reason for the exception set forth in the 1984 amendment. One apparent possibility concerns the different constitutional status of Puerto Rico. Because of this different status, the limitations on Congress's ability to address municipal insolvency in the states discussed above are not directly applicable to Puerto Rico. *United States v. Rivera Torres*, 826 F.2d 151, 154 (1st

---

new definition in the legislative history came in testimony by Professor Frank Kennedy ... who stated: 'I do not understand why the municipal corporations of Puerto Rico are denied by the proposed definition of 'State' of the right to seek relief under Chapter 9, but the addition of the definition of 'State' is useful.'" Brief for C.P. Gillette & D.A. Skeel, Jr., as Amici Curiae Supporting Defendants-Appellants, at *8; *see also* Lubben, 88 Am. Bankr. L.J. at 575 (noting that the exception in § 101(52) says "nothing about how the word 'State' should be interpreted in section 903").

Cir. 1987); *see also Harris v. Rosario*, 446 U.S. 651, 651-52 (1980) (per curiam). Accordingly, Congress may wish to adopt other—and possibly better—options to address the insolvency of Puerto Rico municipalities that are not available to it when addressing similar problems in the states. *See Rivera Torres*, 826 F.2d at 154; *cf.* McConnell & Picker, 60 U. Chi. L. Rev. at 494-95 (arguing that because Chapter 9 "leaves control in the hands of the state" and because "[t]he bankruptcy court lacks the powers typically given to state municipal receivers," "[t]he structure for making decisions that led to financial problems continues").

Our construction is consistent with a congressional choice to exercise such other options "pursuant to the plenary powers conferred by the Territorial Clause." *Rivera Torres*, 826 F.2d at 154. If Puerto Rico could determine the availability of Chapter 9 for Puerto Rico municipalities, that might undermine Congress's ability to do so. *Cf.* Gillette, 79 U. Chi. L. Rev. at 285-86 (discussing the strategic use of municipal bankruptcy relief to avoid other solutions). Similarly, Congress's ability to exercise such other options would also be undermined if Puerto Rico could fashion its own municipal bankruptcy relief. *Cf. id.* The 1984 amendment ensures that these options remain open to Congress by denying Puerto Rico the power to do either.[24] *Cf. id.*

---

[24] Defendants argue that we should not construe § 903(1) to continue to apply to Puerto Rico after the 1984 amendment because to do so creates a "no-man's land" that Congress did not intend and could not have created. We disagree both as to Congress's intent and as to whether a no-man's land is created. Our construction does not create one, because congressional retention of authority is not the same as a no-man's land. Further, defendants' argument fails in any event.

First, defendants' reliance on a congressional report stating that it was "not prepared to admit that the situation presents a legislative no-man's land" reveals nothing about Congress's intent in enacting § 101(52). *Bekins*, 304 U.S. at 51 (quoting H.R. Rep. No. 75-517, at 3 (1937)). Congress, in making the quoted statement, was concerned not with a lack of laws, but a lack of constitutional authority. That statement, made in the wake of the first municipal bankruptcy law's demise in *Ashton*, rejects the view that creation of a federal municipal bankruptcy regime was constitutionally impossible. *See Bekins*, 304 U.S. at 51-54; *cf. Ashton*, 298 U.S. at 530-32. Accordingly, the statement is inapposite; Congress's stated rejection of a legislative no-man's land and assertion of authority is entirely consistent with intending to retain that authority in deciding how to address municipal insolvency in Puerto Rico.

Second, any reliance on *Guss v. Utah Labor Relations Board*, 353 U.S. 1 (1957), is misplaced. Far from creating a rule against the creation of a no-man's land—here, understood as the absence of laws providing relief—the Supreme Court held that where "Congress' power in the area ... is plenary, its judgment must be respected whatever policy objections there may be to [the] creation of a no-man's-land." *Id.* at 11.

The Court's reasoning in *Guss* is fully applicable here: Congress, through the provisions of § 109(c)(2) and § 903, "demonstrated that it knew how to cede jurisdiction to the states" and "demonstrated its ability to spell out with particularity those areas in which it desired state regulation to be operative." *Guss*, 353 U.S. at 9-10 (citation and internal quotation marks omitted). It prohibited states from enacting municipal insolvency laws that would "bind any creditor that does not consent," but not from devising other solutions or from controlling whether their municipalities could access a federal alternative. 11 U.S.C. §§ 109(c)(2), 903. *Guss* therefore supports our conclusion that "Congress has expressed its judgment" to retain its own authority by denying to Puerto Rico both the power to choose Chapter 9 relief and to enact its own version thereof. *Guss*, 353 U.S. at 10-11. Because "Congress' power" over Puerto Rico "is plenary," the Supreme Court dictates that Congress' "judgment [in this regard] must be respected." *Id.*; *Rivera Torres*, 826 F.2d at 154.

C. *The Defendants' Creative But Unsound And Unsuccessful Alternative Readings*

Our construction follows straightforwardly from the plain text and is confirmed by both statutory history and legislative history. Nonetheless, the defendants object to it on two grounds.

First, they offer a novel argument in light of the Bankruptcy Code's definition of "creditor" that the provision only applies to creditors of entities who have or could have filed for Chapter 9 relief: because Puerto Rico cannot authorize its municipalities to become "debtors," those municipalities' bondholders cannot be "creditors," and so the Recovery Act does not bind "creditors" in violation of § 903(1). That is, defendants argue that Congress, without saying so, did indirectly what it could have easily done directly but did not.

Second, they make a structural argument that § 903(1) cannot apply to Puerto Rico because Chapter 9, of which § 903(1) is a part, does not apply to Puerto Rico.

Neither attempt succeeds. If Congress had wanted to exclude Puerto Rico from § 903(1), it would have

---

In any event, these cases do not provide a reason to construe the statute differently. However remarkable a no-man's land might be, assuming dubitante that there is one under our construction, it would be even more remarkable to find that Congress decided to abandon—without comment and through a definition—its forty-year old prohibition on local insolvency laws that bind creditors without their consent. *See Cohen*, 523 U.S. at 221-22. The former can at least be reconciled with congressional purpose to retain its authority, and, if the literature on incentives is correct, may have been the only way for Congress to do so efficaciously. *Cf.* Gillette, 79 U. Chi. L. Rev. at 285-86. Unlike defendants, we cannot "ignore[] [this] more plausible explanation" of Congress's decision. *Kellogg*, 135 S. Ct. at 1977-78.

done so directly without relying on the creativity of parties arguing before the courts. *Cf. Kellogg*, 135 S. Ct. at 1977 ("If Congress had meant to make such a change, we would expect it to have used language that made this important modification clear to litigants and courts."). Instead, as discussed above, Congress did the opposite.

1. *Who May Be "Creditors" under § 903(1)*

Ignoring other language in the Code, the defendants' first argument begins by observing that the Bankruptcy Code defines "creditor" in relation to "debtor." 11 U.S.C. § 101(10)(A) (defining "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor").[25] But a "debtor" is defined as a "person or municipality concerning which a case under [the Bankruptcy Code] *has been commenced*." 11 U.S.C. § 101(13) (emphasis added). Because Puerto Rico cannot authorize its municipalities to commence "a case under [the Bankruptcy Code]," the argument goes, creditors of Puerto Rico municipalities are not "creditors" within the meaning of § 101(10) (A), and so the Recovery Act does not bind "creditors" without their consent in violation of § 903(1).

This argument ignores congressional language choices, as well as context, and proves too much.[26]

---

[25] Subsections (B) and (C) of § 101(10) provide additional definitions of "creditor" not relevant here.

[26] The defendants are correct that their interpretation of "creditor" would not, as the Franklin plaintiffs contend, "reduce Section 903(1) to mere surplus." As Professors Gillette and Skeel explain in their amici curiae brief, their construction of § 903(1), which limits "creditor" to the statutory definition, makes clear that

Although "'[s]tatutory definitions control the meaning of statutory words ... in the usual case,'" *Burgess*, 553 U.S. at 129-30 (second alteration in original) (quoting *Lawson v. Suwannee Fruit & S.S. Co.*, 336 U.S. 198, 201 (1949)), we should not apply statutory definitions in a manner that directly undermines the legislation, *Philko Aviation, Inc. v. Shacket*, 462 U.S. 406, 411-12 (1983) (citing Lawson, 336 U.S. at 201). But that is exactly what defendants ask us to do.[27]

Construing "creditor" in § 903(1) so narrowly would undermine the stated purpose of the provision in prohibiting states from "enact[ing] their own versions of Chapter [9]." *See* S. Rep. No. 95-989, at 110; H.R. Rep. No. 79-2246, at 4. Under defendants' construction, any state could avoid the prohibition by denying its municipalities authorization to file under

---

even though Chapter 9 does not infringe on the power of states to manage their own municipalities,

> a State composition law could not be used to alter a creditor's claim against a municipality that has filed for Chapter 9[:] [a]ny prior or concurrent State law composition proceeding would be superseded pursuant to section 903(1) [upon filing], and any judgment previously obtained would be reopened under section 903(2).

The difficulty is that the Professors' construction cannot be squared with either the history of this provision, or the legislative intent in enacting it, of barring states from enacting their own municipal bankruptcy laws. To the contrary, it would undermine the applicability of this provision to states.

[27] Defendants attempt to escape this conclusion by arguing, in the alternative, that "debtor" is a person against whom a claim "has been [or could be] commenced," and so "creditors" are those who have a claim against an entity eligible for Chapter 9 relief. There is no textual basis to do so. It is simply another gesture at their structural argument, which we address next.

§ 109(c)(2). State laws governing the adjustment of these municipalities' debts could not then, on defendants' reading, "bind any creditor" because there would be none: no case would "ha[ve] been commenced" concerning the municipalities because no case could commence under § 109(c)(2).

Nor does a reference to the changes in 1978 or 1984 make this argument any more plausible. The 1978 version similarly defined "debtor" as a "person or municipality concerning which a case under this title *has been commenced*," and "creditor" in relation to a "debtor" against whom the creditor had a claim "that arose at the time of or before the order for relief." Bankruptcy Reform Act of 1978, §§ 101(9), 101(12), 92 Stat, at 2550-51 (codified at 11 U.S.C. §§ 101(9), 101(12) (1977-1980)) (emphasis added). Defendant's reading undermines the express purpose, stated in 1978, of enacting § 903(1): to "prohibit [] State composition procedures for municipalities." S. Rep. No. 95-989, at 110. If we follow defendants' suggestion, then either Congress was directly self-defeating in enacting this legislation in 1978, or else in 1984 made a stark and drastic change—without comment and in "an obscure way"—to the law as previously enacted. *Cf. Dewsnup*, 502 U.S. at 419; *Kellogg*, 135 S. Ct. at 1977. But "[a] statutory definition should not be applied in such a manner." *Philko Aviation*, 462 U.S. at 412; *see also Dewsnup*, 502 U.S. at 419-20.

Where statutory definitions give rise to such problems, a term may be given its ordinary meaning.[28]

---

[28] The Code is replete with use of the term "creditor" in ways not limited by the statutory definition on which defendants rely. For example, § 502(a) uses creditor in a manner that is expressly inconsistent with the statutory definition because "a creditor of a

general partner in a partnership that is a debtor" is not, itself, a holder of a "claim against the debtor" and so not a "creditor" under § 101(10)(A). *See* 11 U.S.C. § 502(a) ("A claim of interest ... is deemed allowed, unless a party in interest, *including a creditor of a general partner* in a partnership that is a debtor in a case under Chapter 7 ... objects." (emphasis added)).

Similarly, § 101(12A)(C) also uses "creditor" in a manner that is expressly inconsistent with § 101(10)(A). That provision, which defines "debt relief agency" to be "any person who provides any bankruptcy assistance to an assisted person ...," excludes "a creditor of such an assisted person." 11 U.S.C. § 101(12A)(C). But because an "assisted person" might never file for bankruptcy (presumably one of the goals of the agency), an "assisted person" might never become a debtor. "Creditor" here must have its plain meaning.

Following defendants' proffered strict construction would also create mischief for other portions of § 109 itself. For example, an entity may only be a Chapter 9 debtor if it has, *inter alia*, "obtained the agreement of [certain] creditors," "negotiated in good faith with creditors," or been "unable to negotiate with creditors," or else "reasonably believes that a creditor may attempt to obtain a[n] [avoidable] transfer." 11 U.S.C. § 109(c)(5). These requirements refer to the debtor's interactions with its "creditors" *before filing*. But if we mechanically apply the definitions in the manner suggested, we obtain an absurd result: there would have been no creditors with whom to negotiate because "creditors" only exist once a suit "has been commenced," and so all potential debtors would automatically satisfy § 109(c)(5) under the "unable to negotiate with creditors" prong.

The GDB defendants' argument that the district court erred by ignoring the "order for relief" language in the definition of creditor fails for similar reasons. 11 U.S.C. § 101(10)(A) (defining "creditor" as an "entity that has a claim against the debtor that arose at the time of or before *the order for relief* concerning the debtor" (emphasis added)). GDB argues that PREPA's creditors do not have claims that arose at or before "the order for relief" because PREPA is ineligible to receive an "order for relief." But there may never be an "order for relief" if a municipality fails to obtain agreement from, negotiate in good faith with, or show it is unable to negotiate with "creditors." 11 U.S.C. §§ 109(c)(5)(A)-(D).

Philko Aviation, 462 U.S. at 411-12. Doing so resolves the problem: a "creditor" is simply "[o]ne to whom a debt is owed."[29] *Black's Law Dictionary* 424 (9th ed. 2009). With this usage, states cannot escape the reach of § 903(1), in all or specific cases, merely by denying authorization. And so Congress's stated purpose, of preventing "States [from] enact[ing] their own versions of Chapter IX," is fulfilled. S. Rep. No. 95-989, at 110.

As a final effort, the defendants resort to the presumption against preemption. *See Antilles Cement Corp. v. Fortuño*, 670 F.3d 310, 323 (1st Cir. 2012). But "[p]reemption is not a matter of semantics." *Wos v. E.M.A. ex rel. Johnson*, 133 S. Ct. 1391, 1398 (2013). Puerto Rico "may not evade the preemptive force of federal law by resorting to a creative statutory interpretation or description at odds with the statute's intended operation and effect." *Id.* This is particularly true where, as here, the presumption is weak, if present at all. *See United States v. Locke*, 529 U.S. 89, 108 (2000) (citing *Jones v. Rath Packing Co.*, 430 U.S.

Indeed, other provisions of the Bankruptcy Code that use the term "creditor" expressly contemplate that there are "creditors" though there may never be an "order for relief." *See, e.g.*, 11 U.S.C. § 303(c) ("After the filing of a petition ... but before the case is dismissed or relief is ordered, a *creditor* holding an unsecured claim ... may join in the petition...." (emphasis added)).

[29] This definition of "creditor" is essentially the same as the prevailing definition when the prohibition was first enacted and when it was re-codified. *See, e.g.*, *Webster's New International Dictionary of the English Language* 621 (2d ed. 1941) (defining "creditor" as "one to whom money is due"); *Black's Law Dictionary* 476 (3d ed. 1933) (defining "creditor" as "[a] person to whom a debt is owing by another person"); *Webster's Third New International Dictionary of the English Language* 533 (3d ed. 1976) (defining "creditor" as "one to whom money is due"); *Black's Law Dictionary* 441 (rev. 4th ed. 1968) (essentially same as 1933 definition).

519, 525 (1977)) (holding that the presumption is weaker, if triggered at all, where there is not a tradition of state legislation); *Ry. Labor Execs.' Ass'n v. Gibbons*, 455 U.S. 457, 472-73 & n.14 (1982) (noting the nearly exclusive federal presence in the bankruptcy field because of Contracts Clause); *see also* McConnell & Picker, 60 U. Chi. L. Rev. at 427-28 (noting that for much of the nation's history it was thought that states were precluded from enacting municipal bankruptcy legislation). In any event, Congress was quite clear in the Bankruptcy Code that Puerto Rico was to be treated like a state, *except* for the power to authorize its municipalities to file under Chapter 9. 11 U.S.C. § 101(52). This is sufficient to overcome the presumption to the extent it applies. *See Locke*, 529 U.S. at 108 ("The question in each case is what the purpose of Congress was." (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)) (internal quotation marks omitted)).

2. *"State law" under § 903(1)*

Defendants' second argument is that Puerto Rico laws, like the Recovery Act, are not really "State law[s]" for purposes of § 903(1).[30] The argument begins with the observation that § 903(1) appears within the larger provision of § 903, and so is an exception to it.

The terms of § 903 clarify that the remedies of "[t]his chapter" (*i.e.*, Chapter 9) do not alter the ordinary powers, that states have over their municipalities. This provision, together with § 904, "carr[ies] forward doctrines of federal common law that had governed municipal insolvency before the first federal act, as well as the constitutional principle against federal interference in state and local governance." McConnell & Picker, 60 U. Chi. L. Rev. at 462-63 (footnote omitted). "The effect is to preserve the power of political authorities to set their own domestic spending priorities, without restraint from the bankruptcy court." *Id.*; *cf. City of East St. Louis v. United States*, 110 U.S. 321, 324 (1884) (holding that "[n]o court has the right to control [the] discretion [of municipal authorities]" as to "what expenditures are proper and necessary for the municipal administration").

---

[30] The argument that we should read "State" in § 903(1) differently from its statutory definition, as we do "creditor," is a nonstarter: unlike with "creditor," reading the definition mechanically into the provision does not create strange results or ones that are inconsistent with the historic purpose of § 903(1). To the contrary, it confirms that Congress did not intend to alter the historic applicability of § 903(1) to Puerto Rico. *Cf. Cohen*, 523 U.S. at 221; *see also Kellogg*, 135 S. Ct. at 1977 (noting that "(t]he retention of the same term in later laws suggests that no fundamental alteration was intended").

Relying on the context of § 903, the defendants argue that § 903(1), rather than *itself* preempting state municipal bankruptcy laws (or similar), clarifies that the power to enact municipal bankruptcy laws is not one of the powers preserved once Chapter 9 is, or can be, invoked. Because Puerto Rico is *already* excluded from Chapter 9, the argument goes, § 903— including § 903(1)—does not apply because there is no need to stipulate that the remedies of Chapter 9 do not undermine Puerto Rico's control over its own municipalities.

The defendants further argue that the presumption against preemption bolsters this reasoning and provides a reason to adopt this argument. *See Antilles Cement*, 670 F.3d at 323. Indeed, they argue that the presumption applies to this case with particular force because "Title 11 suspends the operation of state insolvency laws except as to those classes of persons specifically excluded from being debtors under the Code." *In re Cash Currency Exch., Inc.*, 762 F. 2d 542, 552 (7th Cir. 1985) (holding that currency exchanges were not excluded from being debtors under the Code, such that their filing under Chapter 11 was permitted, and rejecting the argument that a state insolvency law might preclude such exchanges from filing). "[T]o permit the blocking of [a] state reorganization herein," defendants argue, "would be tantamount to imposing a federal reorganization which is clearly forbidden by the Act's exemption" of Puerto Rico municipalities, and is "inconsistent with the congressional scheme of the Bankruptcy Act" which sought to provide to states a mechanism that was unavailable under the Contracts Clause. *In re Bankers Trust Co.*, 566 F.2d 1281, 1288 (5th Cir. 1978) (discussing the Bankruptcy Act's "exemption of savings and loan associations"); *see*

generally McConnell & Picker, 60 U. Chi. L. Rev. 425 (explaining how the federal law attempts to provide states with a mechanism to solve the holdout problem of municipal bankruptcy).

To accept the defendants' reading, we must accept one of the two following propositions: Either states that do not authorize their municipalities to file for Chapter 9 relief are similarly "exempted," and so not barred by § 903(1) from enacting their own bankruptcy laws. Or the availability of Chapter 9 relief for state municipalities, regardless of whether a particular state chooses to exercise the option, occupies the field of nonconsensual municipal debt restructuring, and § 903(1) merely aims to clarify that the operative clause of § 903 does not undermine that background assumption. Thus, ironically, it is the defendants' argument which relies on the notion of field preemption.

We have already rejected the first proposition, for the reasons stated above. The second is undermined by the very presumption against preemption that defendants seek to employ: field preemption is generally disfavored absent clear intent, and is, in any event, unnecessary in light of § 903(1). *See Arizona v. United States*, 132 S. Ct. 2492, 2501 (2012); *Mass. Ass'n of Health Maint. Orgs. v. Ruthardt*, 194 F.3d 176, 178-79 & n.1 (1st Cir. 1999); *cf.* C. Nelson, *Preemption*, 86 Va. L. Rev. 225, 227-28 & n.12 (2000) ("The Court has grown increasingly hesitant to read implicit field-preemption clauses into federal statutes.").

Defendants' second argument fails for another, related reason. For if field preemption of municipal bankruptcy exists by virtue of the availability of

Chapter 9, the defendants must show that it does *not* apply to Puerto Rico. This they cannot do.

Unlike state bankruptcy laws governing banks and insurance companies, which are not preempted by the federal Code in light of congressional language which directly and expressly excludes them from the Code, 11 U.S.C. § 109(b); *see In re Cash Currency*, 762 F.2d at 552, the exclusion of Puerto Rico municipalities is not direct and is of a different sort. Rather, Puerto Rico is precluded from granting its municipalities the required authorization, and so its municipalities fail to *qualify* for the municipal bankruptcy protection that is available. 11 U.S.C. §§ 101(52), 109(c)(2). But failure to qualify is not the same as direct and express exclusion. On defendants' reasoning, states could offer bankruptcy relief to municipalities that fail to qualify for municipal bankruptcy protection for other reasons—including, for example, municipalities that are not "insolvent" as required by § 109(c)(3), or that refuse to "negotiate[] in good faith" with creditors as required by § 109(c)(5). To exclude such municipalities from the preemptive scope of § 903(1) would be an absurd result. The terms of § 101(52) do not *exclude* Puerto Rico municipalities from federal relief; rather, they *deny* to Puerto Rico the authority to decide when they might access it. On this reading, absent further congressional action, § 903(1) still applies.

3. *Conflict Preemption*

Before moving on, we pause to note that defendants' arguments fail in any event, for they assume that a law containing the provisions of the Recovery Act, so long as it is passed by either Puerto Rico or the District of Columbia, is not otherwise preempted. But even where an express preemption provision does not apply,

federal law preempts state laws that "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *See Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 204 (1983) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)) (internal quotation marks omitted). Where this occurs, conflict preemption also applies. *See In re Celexa & Lexapro Mktg. & Sales Practices Litig.*, 779 F.3d 34, 40 (1st Cir. 2015) (citing *Freightliner Corp. v. Myrick*, 514 U.S. 280, 287 (1995)).

Conflict preemption applies here because the Recovery Act frustrates Congress's undeniable purpose in enacting § 903(1). As discussed above, all of the relevant authority shows that Congress quite plainly wanted a single federal law to be the sole source of authority if municipal bondholders were to have their rights altered without their consent. *See, e.g.*, H.R. Rep. No. 79-2246, at 4 ("Only under a Federal law should a creditor be forced to accept such an adjustment without his consent."). But the Recovery Act does just that: both Chapter 2 and Chapter 3 relief, the only forms of relief under the Recovery Act, bind creditors without their consent.[31] Thus, there is an independent basis to affirm, namely that the Recovery Act is also preempted under conflict preemption principles.

---

[31] For this reason, we also reject the GDB defendants' contention that at least part of the Act is severable from any portion of the law so preempted. The GDB defendants point to two different areas of the Recovery Act, §§ 307-09, and § 135. On their face, these provisions are dependent on the sustainability of the remainder of the law, and so cannot survive independently of the Act. Nor, we note, have we found any other section which might stand alone.

That conflict preemption applies confirms our conclusion that Congress did not remove Puerto Rico and the District of Columbia from the express reach of § 903 or § 903(1). *See Pac. Gas*, 461 U.S. at 204. Defendants would have us hold that Congress somehow inadvertently introduced a provision into the Code that would fly in the face of its long-professed intent to ensure that all municipalities seeking reorganization must do so under federal law. *See, e.g.*, H.R. Rep. No. 79-2246, at 4; S. Rep. 95-989, at 110. But we should not accept defendants' invitation to impute mistakes to Congress to reach defendants' desired result. *Cf. Jackson v. Liquid Carbonic Corp.*, 863 F.2d 111, 114 (1st Cir. 1988) ("Our task in construing the statutory language is 'to interpret the words of the[ ] statute[ ] in light of the purposes Congress sought to serve.'" (alterations in original) (quoting *Chapman v. Hous. Welfare Rights Org.*, 441 U.S. 600, 608 (1979))); *Philko Aviation*, 462 U.S. at 411 ("Any other construction would defeat the primary congressional purpose for the [provision's] enactment...."); *Demko v. United States*. 216 F.3d 1049, 1053 (Fed. Cir. 2000) ("When a statute is as clear as a glass slipper and fits without strain, courts should not approve an interpretation that requires a shoehorn.").

D. *Tenth Amendment Concerns*

Finally, defendants argue that the canon of constitutional avoidance weighs against our view of congressional intent as to preemption. They argue that if § 903(1) bars the Recovery Act because it expressly preempts local municipal bankruptcy law, then it directly raises a constitutional question under the Tenth Amendment of whether § 903(1) (and (2)) "constitute[s] an impermissible interference with a

state's control over its municipalities." 6 *Collier on Bankruptcy* ¶ 903.03 [2] (A.N. Resnick & H.J. Sommer, eds., 16th ed. 2015). The concern is that:

> If a state composition procedure does not run afoul of the [C]ontracts [C]lause, then municipal financial adjustment under a state procedure should be a permissible exercise of state power, and a congressional enactment prohibiting that exercise would be congressional overreaching in violation of the Tenth Amendment.

Id.; *cf. City of Pontiac Retired Emps. Ass'n v. Schimmel*, 751 F.3d 427, 430-31 (6th Cir. 2014) (en banc) (per curiam) (declining to reach the issue on appeal).

Our construction leaves this question open and we need not resolve it in this case.[32] The limits of the Tenth Amendment do not apply to Puerto Rico, which is "*constitutionally* a territory," *United States v. Lopez Andino*, 831 F.2d 1164, 1172 (1st Cir. 1987) (Torruella, J., concurring), because Puerto Rico's powers are not "[those] reserved to the States" but those specifically granted to it by Congress under its constitution. *See* U.S. Const, art. IV, § 3, cl. 2; *id.*, amend. X; *Davila-Perez v. Lockheed Martin Corp.*, 202 F. 3d 464, 460 (1st Cir. 2000) (citing *Harris*, 446 U.S. 651). Accordingly,

---

[32] For example, there may be a saving construction of § 903(1) that narrows its preemptive scope, an issue we did not reach because we were not called upon to define the limits of § 903(1)'s preemptive effect. *Cf. City of Pontiac*, 751 F.3d at 430-31. Or it may be the case that the Bankruptcy Clause permits this imposition on state sovereignty and that *Ashton* is no longer good law. *Cf.* McConnell & Picker, 60 U. Chi. L. Rev. at 451-52 (citing *Ashton*, 298 U.S. at 530-31); Lubben, 88 Am. Bankr. L.J. at 566.

that § 903(1) expressly preempts a Puerto Rico law does not implicate these Tenth Amendment concerns.

IV.

We observe, in closing, that municipal bankruptcy regimes run a particularly difficult gauntlet between remedying the "holdout problem" among creditors that bankruptcy is designed to resolve, and avoiding the "moral hazard" problem presented by the availability of bankruptcy relief—namely, "the tendency of debtors to prefer to devote their resources to their own interests instead of repaying their debts." *See* McConnell & Picker, 60 U. Chi. L. Rev. at 426.

In creating federal Chapter 9 relief for states, Congress's ability to effectively run this gauntlet was constrained by our federalist structure and the limitations posed by the Tenth Amendment. *See id.* at 428, 494. But Congress is not so constrained in addressing Puerto Rican municipal insolvency owing to Puerto Rico's different constitutional status. *Cf. id.*; *Harris*, 446 U.S. at 651-52. That is, other solutions may be available.

In denying Puerto Rico the power to choose federal Chapter 9 relief, Congress has retained for itself the authority to decide which solution best navigates the gauntlet in Puerto Rico's case. The 1984 amendment ensures Congress's ability to preventing Puerto Rico from strategically employing Chapter 9 relief under § 109(c), and from strategically its own version under § 903(1), to avoid such options as Congress may choose. *See* Gillette, 79 U. Chi. L. Rev. at 285-86. We must respect Congress's decision to retain this authority.

We *affirm*. No costs are awarded.

- Concurring Opinion Follows -

TORRUELLA, *Circuit Judge* (Concurring in the judgment).

Since at least 1938, the definition of the term "States" in § 1(29) of the Bankruptcy Act included the Territories and possessions of the United States, making Puerto Rico's municipalities eligible for federal bankruptcy protection.[33] All parties to this case agree that this is so. As provided in § 109(c)(2) of the Bankruptcy Reform Act of 1978, a municipality could be an eligible debtor under Chapter 9 if it was "generally authorized to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to [so] authorize."[34] This situation remained unchanged until 1984[35] when Congress enacted § 421(j)(6) of the Bankruptcy Amendments and Federal Judgeship Act of 1984[36] (the "1984 Amendments"), which—for the first time—eliminated Puerto Rico's decades-long power to seek federal bankruptcy protection for its municipalities by amending § 101(52) to exclude Puerto Rico's ability under § 109(c)(2) to authorize a "debtor" for purposes of Chapter 9.

Because there is no dispute that under the pre-1984 federal bankruptcy laws, Puerto Rico had—as did all

---

[33] *See* Act of June 22, 1938, Pub. L. No. 75-696, ch. 575, § 1 (29), 52 Stat. 840, 842.

[34] Pub. L. No. 95-598, § 109(c)(2), 92 Stat. 2549, 2557. The current text requires "specific" authorization by State law rather than "general" authorization. 11 U.S.C. § 109(c)(2).

[35] The majority accurately recounts the legislative path of the predecessors to the bankruptcy section presently in controversy. *See* Maj. Op. at 13-16.

[36] Pub. L. No. 98-353, sec. 421(j)(6), § 101(44), 98 Stat. 333, 368-69 (codified as amended at 11 U.S.C. § 101(52)).

the states—the power to authorize its municipalities to file for the protection of Chapter 9, I agree with the majority's conclusion that the 1984 Amendments are the "key to this case."

Although I also agree that Puerto Rico's Recovery Act contravenes § 903(1)—which applies uniformly to Puerto Rico, together with the rest of Chapter 9—and thus is invalid, I am compelled to write separately in order to note that the 1984 Amendments are equally invalid. Not only do they attempt to establish bankruptcy legislation that is not uniform with regards to the rest of the United States, thus violating the uniformity requirement of the Bankruptcy Clause of the Constitution,[37] but they also contravene both the Supreme Court's and this circuit's jurisprudence in that there exists no rational basis or clear policy policy reasons for their enactment. *See Harris v. Rosario*, 446 U.S. 651, 651-52 (1980) ("Congress, which is empowered under the Territory Clause of the Constitution ... to 'make all needful Rules and Regulations respecting the Territory ... belonging to the United States,' *may treat Puerto Rico differently from States so long as there is a rational basis for its actions*." (emphasis added)) (per curiam); *Califano v. Torres*, 435 U.S. 1, 5 (1978) (per curiam); *Córdova & Simonpietri Ins. Agency. Inc., v. Chase Manhattan Bank N.A.*, 649 F.2d 36, 41-42 (1st Cir. 1981) ("We believe that there would have to be specific evidence or *clear policy reasons embedded in a particular statute* to demonstrate a statutory intent to intervene more extensively into the local affairs of post-Constitutional Puerto Rico than into the local affairs of a state." (emphasis added)).

---

[37] U.S. Const, art. I, § 8, cl. 4.

Furthermore, to assume that the 1984 Amendments are a valid exercise of Congress's powers to manage the local financial affairs of Puerto Rico's municipalities is inconsistent with this court's long-lasting Commonwealth-endorsing case law. Finally, I also take issue with the majority's proposal that Puerto Rico simply ask Congress for relief; such a suggestion is preposterous given Puerto Rico's exclusion from the federal political process.

I. *Congress's Uniform Power under the Bankruptcy Clause*

In enacting the 1984 Amendments, Congress acted pursuant to the power enumerated in the Bankruptcy Clause, which states that "Congress shall have the power ... [t]o establish ... *uniform laws on the subject of bankruptcies throughout the United States*." U.S. Const, art. I, § 8, cl. 4. The term "uniform" is unequivocal and unambiguous language, which is defined as "always the same, as in character or degree; unvarying,"[38] and as "[c]haracterized by a lack of variation; identical or consistent."[39] Prohibiting Puerto Rico from authorizing its municipalities to request Chapter 9 relief, while allowing all the states to benefit from such power, is hardly in keeping with these definitions.[40] It would be absurd to argue that the

---

[38] *The American Heritage Dictionary of the English Language* 1881 (4th ed. 2000).

[39] *Black's Law Dictionary*, 1761 (10th ed. 2014).

[40] Any effort to understand rather than rewrite the Bankruptcy Clause must accept and apply the presumption that the lawmakers used words in "their natural and ordinary signification." *Pensacola Tel. Co. v. W. Union Tel. Co.*, 96 U.S. 1, 12 (1878). Furthermore, it has long been established as a fundamental rule of statutory construction that lawmakers do not

exclusion of Puerto Rico from the protection of the Bankruptcy Code by the enactment of the 1984 Amendments is not prohibited by the unequivocal language of the Bankruptcy Clause of the Constitution. This should end the analysis of Congress's powers under the Constitution, as "reliance on legislative history is unnecessary in light of the statute's unambiguous language." *Mohamad v. Palestinian Auth.*, 132 S. Ct. 1702, 1709 (2012) (quoting *Milavetz, Gallop & Milavetz, P.A. v. United States*, 559 U.S. 229, 236 n.3 (2010)); *see also Circuit City Stores. Inc. v. Adams*, 532 U.S. 105, 119 (2001) ("[W]e do not resort to legislative history to cloud a statutory text that is clear." (alteration in original) (quoting *Ratzlaf v. United States*, 510 U.S. 135, 147-148 (1994))).

Even if we did turn to legislative history, there is little in the Federalist Papers, or elsewhere in our canonical sources, to aid us in finding any hidden meaning to the clear language of the Bankruptcy Clause.[41] This gives added weight to the conclusion

---

use terms in enactments that "have no operation at all." *Marbury v. Madison*, 1 Cranch 137, 174 (1803) ("[O]ur task is to apply the text, not to improve upon it."); *see also Pavelic & LeFlore v. Marvel Entm't Grp. Div. of Cadence Indus. Corp.*, 493 U.S. 120, 126 (1989).

[41] *See* The Federalist No. 42, at 237 (James Madison) (Robert A. Ferguson, ed., 2006) ("The power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent many frauds where the parties or property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question."). No further comment is found before the Bankruptcy Clause was incorporated into the Constitution as it presently appears. It also bears noting that the Congressional powers to regulate commerce uniformly under the Commerce Clause—which contains language identical to the Bankruptcy Clause—apply in full force to Puerto

that the language in the Clause means what it unequivocally states: bankruptcy laws must be *uniform* throughout the United States or else are invalid. *See* Daniel A. Austin, *Bankruptcy and the Myth of "Uniform Laws"*, 42 Seton Hall L. Rev. 1081, 1141-47 (2012); Judith Schenck Koffler, *The Bankruptcy Clause and Exemption Laws: A Reexamination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. Rev. 22, 99 (1983).

Although Congress's powers under the Bankruptcy Clause are broad,[42] they are nonetheless limited by the Clause's uniformity requirement, which is geographical in nature. *Ry. Labor Execs, Ass'n v. Gibbons*, 455 U.S. 457, 471 (1982) ("A law can hardly be said to be uniform throughout the country if it applies only to one debtor and can be enforced only by the one bankruptcy court having jurisdiction over the debtor." (citing *In Re Sink*, 27 F.2d 361, 363 (W.D. Va. 1928), *appeal dismissed per stipulation*, 30 F.2d 1019 (4th Cir. 1929))). "The uniformity requirement ... prohibits Congress from enacting a bankruptcy law that ... applies only to one regional debtor. To survive scrutiny under the Bankruptcy Clause, a law must at least apply uniformly to a defined class of debtors." *Id.* at 473; *cf. Blanchette v. Conn. Gen. Ins. Corps.*, 419 U.S. 102, 159 (1974).

Rico. *See Trailer Marine Transp. Corp. v. Rivera Vazquez*, 977 F.2d 1, 8 (1st Cir. 1992) ("The central rationale of [the] dormant Commerce Clause doctrine ... is ... to foster economic integration and prevent local interference with the flow of the nation's commerce. This rationale applies with equal force to official actions of Puerto Rico. Full economic integration is as important to Puerto Rico as to any state in the Union." (citation omitted)).

[42] *See Cont'l Ill. Nat'l Bank v. Chicago, R.I. & Pac. Ry. Co.*, 294 U.S. 648, 668 (1935).

II. *The 1984 Amendments Fail the Rational Basis Requirement*

The non-uniform treatment of Puerto Rico under the bankruptcy laws not only violates the Bankruptcy Clause, but also fails the rational basis requirement. As explained above, *Harris*, 446 U.S. at 651-52, and *Califano*, 435 U.S. at 5, held that Congress may legislate differently for Puerto Rico, as long as it has a rational basis for such disparate treatment. These were equal protection and substantive due process cases brought by U.S. citizens of Puerto Rico who challenged Congress's discriminatory treatment in certain welfare programs. The plaintiffs in these cases claimed to have been discriminated against based on their classification as Puerto Ricans, an insular minority purportedly subject to heightened scrutiny. However, the Supreme Court rejected their argument, holding that, pursuant to Congress's powers under the Territorial Clause, only rational basis review is warranted when considering the validity of a statute that treats Puerto Rico differently. *Harris*, 446 U.S. at 651-52; *Califano*, 435 U.S. at 5.[43]

It is black letter law that this tier of scrutiny "is a paradigm of judicial restraint," *FCC v. Beach Commc'ns, Inc.*, 508 U.S. 307, 314 (1993), and courts should not question "[rjemedial choices made by ... legislative ... bod[ies] [unless] 'there exists no fairly conceivable set of facts that could ground a rational

---

[43] The same rational basis requirement that regulates disparate treatment of Puerto Ricans applies to the Commonwealth itself. *See Jusino-Mercado v. Puerto Rico*, 214 F.3d 34, 44 (1st Cir. 2000) (citing *Harris*, 446 U.S. at 651-52) (recognizing that Congress could have legislated differently for the Commonwealth).

relationship between the challenged classification and the government's legitimate goals.'" *Medeiros v. Vincent*, 431 F.3d 25, 29 (1st Cir. 2005) (quoting *Wine and Spirits Retailers, Inc. v. Rhode Island*, 418 F.3d 36, 54 (1st Cir. 2005)).

This implies that Congress's justification for its legislative actions need not be expressly articulated, and thus the action of removing Puerto Rico's power to authorize its municipalities to file under Chapter 9 must be allowed if there is any set of conceivable reasons rationally related to a legitimate interest of Congress. *See Beach Commc'ns*, 508 U.S. at 313 ("[A] statutory classification that neither proceeds along suspect lines nor infringes fundamental constitutional rights must be upheld against equal protection challenges if there is any reasonably conceivable state of facts that could provide a rational basis for the classification."). Furthermore, in order to pass rational basis review, legislation cannot be arbitrary or irrational. *See City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 446 (1985) ("The State may not rely on a classification whose relationship to an asserted goal is so attenuated as to render the distinction arbitrary or irrational."). Here, there is no conceivable set of facts rationally related to a legitimate purpose of Congress in these amendments, and thus these amendments are invalid.

This legislation unreasonably and arbitrarily removed a power delegated to Puerto Rico by the previous legislation. Had there been any justification for not granting Puerto Rico the managerial power to authorize its municipalities to seek bankruptcy protection before 1984, Congress certainly did not express or even imply it at any time up to and

including the present. How could such a justification arbitrarily materialize without explanation?

A. The 1984 Amendments Lack any Record or Justification

As previously stated, there is no legislative record on which to rely for determining Congress's reasons behind the 1984 Amendments. A tracing of its travels through the halls of Congress sheds less light than a piece of coal on a moonless night regarding the reason for its enactment. Thus, the majority's statement that "Congress [sought to] preserve to itself th[e] power to authorize Puerto Rican municipalities to seek Chapter 9 relief,"[44] is pure fiction. There is absolutely nothing in the record of the 1984 Amendments to justify this statement or Congress's legitimate purpose in adopting them.

The Puerto Rico exception actually predates the 1984 Act. It appeared out of thin air during the 96th Congress in 1980 in a House Report, accompanying S. 658. *See* H.R. Rep. No. 96-1195, at 38 (1980). That proposal was a failed bill similar in substance to Pub. L. No. 98-353, which later became the Bankruptcy Amendments and Federal Judgeship Act of 1984, 98 Stat. 333. *See* 98 Stat. 368-69 (containing the Puerto Rico language under "Subtitle H - Miscellaneous Amendments to Title 11"). When S. 658 arrived in the House from the Senate, on September 11, 1979, it did not contain the Puerto Rico-excluding language. The Puerto Rico provision was, however, included in the version that emerged from the House Committee on the Judiciary on July 25, 1980. There is no legislative history on the Puerto Rico clause, as hearings from the

---

[44] Maj. Op. at 5.

House Committee on the Judiciary from 1979-1980 reveal nothing about the amendment's purpose or justification.

The story was not very different with regard to the 1984 Amendments. On March 21, 1984, the House passed H.R. 5174 without the Chapter 9 debtor eligibility exclusion for Puerto Rico. On that same day, Senator Strom Thurmond (R-SC) introduced S. Amdt. 3083. Subtitle I, section 421(j)(6) of the amendment proposed altering Section 101 of Title 11 to provide that "(44) 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title." 130 Cong. Rec. S6118 (daily ed. May 21, 1984) (statements of Sen. Thurmond). And that is how we got the current text of 11 U.S.C. § 101(52). On the day that he introduced the amendment. Senator Thurmond addressed the Senate to explain several of its numerous stipulations, yet said little about the newly added Puerto Rico exemption. He noted, "Subtitles C through I contain the remaining substantive provisions passed by the Senate in S. 1013. These provisions were not in the House bill. They do, however, have broad support in the Senate and were therefor included in the substitute amendment." 130 Cong. Rec. S6083 (daily ed. May 21, 1984) (statement of Sen. Thurmond).

The original S. 1013 also did not contain the Puerto Rico exclusion when it was reported in the Senate on April 7, 1983. Senators Dole, Thurmond, and Hefflin introduced Amendment 1208 on April 27, 1983, which contained the Puerto Rico Chapter 9 debtor eligibility exclusion. 129 Cong. Rec. S5441 (daily ed. Apr. 27, 1983). The Senators gave no explanation for the Puerto Rico exclusion in S. 1013. Thurmond described

Subtitle I of Amendment 3083 as "Technical Amendments to Title 11," which is consistent with the rest of the statute and gave no further reasons for its inclusion. 130 Cong. Rec. S6083 (daily ed. May 21, 1984) (Statement of Sen. Strom Thurmond). The Senate Amendments to H.R. 5174, including 3083, passed on June 20, 1984. The Congressional Record from the House on that day announced that "the Senate insists upon its amendments" and therefore it would have to conference with the House which was not in agreement with them. 130 Cong. Rec. H6085 (daily ed. June 20, 1984).

The House adopted the Conference Report, including the Puerto Rico exclusion, without specific mention or comment on June 28, 1984, with a vote of 394 yeas, 0 nays, and 39 abstentions. The Senate also voted for the Conference Report, thereby making H.R. 5174 into Public Law No. 98-353. Congress never articulated a reason for the Puerto Rico-excluding language.

To ignore this silence is striking given that the central task for courts when interpreting changes to the bankruptcy statutes is to carefully examine Congress's statutory text and justifications. *See Cohen v. de la Cruz*, 523 U.S. 213, 221 (1998) ("We ... 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.'" (citation omitted)); *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 380 (1980) ("Such a major change in the existing rules would not likely have been made without specific provision in the text of the statute; it is most improbable that it would have been made without even any mention in the legislative

history." (citation omitted)); *cf. Kellogg Brown & Root Servs. Inc. v. United States ex rel. Carter*, 135 S. Ct. 1970, 1977 (2015) ("Fundamental changes in the scope of a statute are not typically accomplished with so subtle a move.").

Tellingly, the parties do not dispute this absolute lack of Congressional justification for the Puerto Rico language in the 1984 Amendments. *See also* Frank R. Kennedy, *The Commencement of a Case under the New Bankruptcy Code*, 36 Wash. & Lee L. Rev. 977, 991 n.75 (1979) ("While there may be special reasons why Washington, D.C., should not be eligible for relief under Chapter 9, it is not self-evident why all political subdivisions, public agencies, and instrumentalities in Puerto Rico, Guam, and other territories and possessions of the United States should be precluded from relief under the chapter.").

And yet, there is one undisputed fact that is self-evident in all this: no one proposed a need for the 1984 change, or protested the efficacy of the Code as it existed without this amendment. There is hermetic silence regarding all of the issues or questions that would normally arise and be discussed when a provision that was on the Bankruptcy Code for close to half a century, and whose elimination would affect millions of U.S. citizens, is deleted.

B. Congress's Power over Puerto Rico's Internal Affairs

The 1984 Amendments deprived Puerto Rico of a fundamental and inherently managerial function over its municipalities that has no connection to any articulated or discernible Congressional interest. *See Bennet v. City of Holyoke*, 362 F.3d 1, 12 (1st Cir. 2004) (explaining that "municipalities are creatures of the

state" subject to control of the state's legislature). All the states and territories—including Puerto Rico before 1984—had the power to control, manage, and regulate the local financial affairs of their municipalities. *See Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 513-15 (1942); *Armstrong v. Goyco*, 29 F.2d 900, 902 (1st Cir. 1928) ("In the matter of local regulations and the exercise of police power Porto Rico possesses all the sovereign powers of a state, and any exercise of this power which is reasonable and is exercised for the health, safety, morals, or welfare of the public is not in contravention of the Organic Act nor of any provision of the Federal Constitution."). As the Court explained in *Faitoute Iron & Steel Co.*,

> Can it be that a power that ... was carefully circumscribed to reserve full freedom to the states, has now been completely absorbed by the federal government—that a state which ... has ... elaborate[d] machinery for the autonomous regulation of problems as peculiarly local as the fiscal management of its own household, is powerless in this field? We think not.

316 U.S. at 508-09; *see also New York v. United States*, 505 U.S. 144, 156-57 (1992) (explaining that the structure of the Constitution protects the rights of the states to control their internal affairs). Puerto Rico has the same level of authority over its municipalities. *See United States v. Laboy-Torres*, 553 F.3d 715, 722-23 (3d Cir. 2009) (O'Connor, J., sitting by designation) ("[C]ongress has accorded the Commonwealth of Puerto Rico 'the degree of autonomy and independence normally associated with States of the Union.'")

(quoting *United States v. Cirino*, 419 F.3d 1001, 1003-04 (9th Cir. 2005) (per curiam)).

When the Supreme Court held in 1976 that Puerto Rico has "[t]he degree of autonomy and independence normally associated with States of the Union,"[45] it reaffirmed this proposition, which had longstanding vitality even before the 1984 Amendments or the enactment of the Federal Relations Act[46] and the creation of the so-called "Commonwealth status." *See Puerto Rico v. Shell Co.*, 302 U.S. 253, 261-62 (1937) ("The aim of the Foraker Act and the Organic Act was to give Puerto Rico full power of local self-determination with an autonomy similar to that of the states and incorporated territories.").

Even this court has questioned the basis for Congress's power to legislate over Puerto Rico local affairs. In one of its Commonwealth-endorsing decisions dealing with the question of whether Congress had the intention to limit Puerto Rico's powers to regulate internal antitrust violations through the Sherman Act's control of purely local affairs of the territories, the court held that "[t]he states are clearly able to adopt such variations as to purely local matters. And, *there is no reason of policy discernible in the Sherman Act* for treating Puerto Rico differently." Cordova, 649 F.2d at 42 (emphasis added).[47] The court went on to explain how Congress's

---

[45] *Examining Bd. of Eng'rs, Architects & Surveyors v. Flores de Otero*, 426 U.S. 572, 594 (1976).

[46] Act of July 3, 1950, Pub. L. No. 81-600, ch. 446, 64 Stat. 319 (codified at 48 U.S.C. § 731b *et seq.*); 48 U.S.C. § 821.

[47] As in *Córdova*, there is no discernible policy justification in the Bankruptcy Code to support the conclusion that Congress intended to control the purely local affairs of Puerto Rico. In fact,

power to legislate purely local affairs of Puerto Rico is constrained: "We believe that there would have to be specific evidence *or clear policy reasons* embedded in a particular statute to demonstrate a statutory intent to intervene more extensively into the local affairs of post-Constitutional Puerto Rico than into the local affairs of a state." *Id.* at 42 (emphasis added); *see also Antilles Cement Corp. v. Fortuño*, 670 F.3d 310, 322 (1st Cir. 2012).

In the instant case, there are no articulated or conceivable "clear policy reasons." And while the "specific evidence" requirement could be met by the clear statutory text of the 1984 Amendments, this court has stated that Congress's powers to legislate differently for Puerto Rico under the Territorial Clause are also subject to some "outer limits," in addition to the rational-basis constraints of *Harris* and *Califano*. *See Jusino-Mercado*, 214 F.3d at 44. At a minimum, there should be some explanation as to why Congress's enactment of the 1984 Amendments fits within those "outer limits" given the complete absence of clear policy reasons.

Congress has expressly delegated to Puerto Rico the power to manage its municipalities. Section 37 of the Federal Relations Act provides:

> That the legislative authority herein provided shall extend to all matters of a legislative character not locally inapplicable, including power to create, consolidate, and

---

if anything, the policy reasons embodied in the constitutional requirement that bankruptcy legislation be uniform throughout the United States would support the opposite conclusion. The 1984 Amendments clearly violate the constitutional policy mandate.

> reorganize the municipalities so far as may be necessary, and to provide and repeal laws and ordinances therefor; also the power to alter, amend, modify, or repeal any or all laws and ordinances of every character now in force in Puerto Rico or municipality or district thereof, insofar as such alteration, amendment, modification, or repeal may be consistent with the provisions of this Act.

P.R. Laws Ann. tit. 1, Federal Relations Act § 37; Federal Relations Act, Pub. L. No. 64-368, § 37, 39 Stat. 951, 954 (1917), *as amended by* Act of July 3, 1950, Pub. L. No. 81-600, 64 Stat. 319 (codified at 48 U.S.C. § 821).[48]

This court has further reiterated the norm that Puerto Rico has authority to control its internal affairs in several other Commonwealth-endorsing decisions. *See, e.g.. United States v. Quiñones*. 758 F.2d 40, 42 (1st Cir. 1985) ("Puerto Rico ceased being a territory of the United States subject to the plenary powers of Congress as provided in the Federal Constitution .... [T]he government of Puerto Rico is no longer a federal government agency exercising delegated power."); *Córdova*, 649 F.2d at 41. Because Congress was

---

[48] For a more detailed description of Puerto Rico's powers to control its internal affairs, even before the "Commonwealth status," *see, e.g., People of Porto Rico v. E. Sugar Assocs.*, 156 F.2d 316, 321 (1st Cir. 1946) ("[T]his grant of legislative power with respect to local matters ... is as broad and comprehensive as language could make it.... [T]he legislative powers conferred upon the Insular Legislature by Congress are nearly, if not quite, as extensive as those exercised by the state legislatures." (citations and internal quotation marks omitted)); *González v. People of Porto Rico*, 51 F.2d 61, 62 (1st Cir. 1932) (quoting *Armstrong*, 29 F.2d at 902).

precluded from enacting the 1984 Amendments, they cannot serve a legitimate purpose and are therefore irrational.

The degree of authority granted to Puerto Rico to regulate its local affairs is very different from Congress's exclusive powers over the District of Columbia, the other territory excluded by § 101(52) from authorizing its municipalities under § 109(c)(2) of the Bankruptcy Code. *See Trailer Marine Transp. Corp.*, 977 F.2d at 8 ("If the government of Puerto Rico were nothing other than the alter ego or immediate servant of the federal government, then the dormant Commerce Clause doctrine would have no pertinence, for a doctrine designed to safeguard federal authority against usurpation has no role when the federal government itself is effectively the actor."); *cf. Palmore v. United States*, 411 U.S. 389, 397 (1973) ("Not only may statutes of Congress of otherwise nationwide application be applied to the District of Columbia, but Congress may also exercise all the police and regulatory powers which a state legislature or municipal government would have in legislating for state or local purposes."); *Berman v. Parker*, 348 U.S. 26, 31 (1954) ("The power of Congress over the District of Columbia includes all the legislative powers which a state may exercise over its affairs.").

Any comparison of Puerto Rico to the District of Columbia, therefore, including the proposition made by the majority that Congress may have intended to retain plenary powers to regulate the local affairs of Puerto Rico as it does for the seat of the Federal Government, fundamentally changes the current nature of Puerto Rico-federal relations. To argue that Congress's rationale for the disparate treatment

enacted in the 1984 Amendments is that it may have wanted to adopt "other—and possibly better—options to address the insolvency of Puerto Rico municipalities"[49] overturns over half a century of binding case law that purported to recognize that Congress delegated to Puerto Rico the power to control its municipalities and legislate for its local affairs. Congress's solution to the budgetary and fiscal crisis faced by the District of Columbia during the mid-1990s, through the enactment of the District of Columbia Financial Responsibility and Management Assistance Act of 1995, Pub. L. No. 104-8, 109 Stat. 97, could have been taken for granted considering that the Federal Government and Congress itself would be directly affected by the District's financial crisis. But, the circumstances here are very different, since no such sense of urgency is evident in Congress, nor is the requisite political clout available to Puerto Ricans. And, even if it were, instituting direct Congressional control of Puerto Rico's finances through a financial control board would require fundamentally redefining Puerto Rico's relationship to the United States. *See Flores de Otero*, 426 U.S. at 594.

Without an adequate explanation, the majority chooses to ignore our own binding case law and suggests that Congress chose to unreasonably interfere with a managerial decision affecting Puerto Rico's local municipal affairs. Although Congress may, in special circumstances, legislate to amend or repeal uniform bankruptcy legislation, such an act, on a totally silent record, cannot be rational considering the long and substantiated jurisprudence that militates to the contrary.

---

[49] Maj. Op. at 31.

C. Rational Basis Review After *Harris* and *Califano*

This is an extraordinary case involving extraordinary circumstances, in which the economic life of Puerto Rico's three-and-a-half million U.S. citizens hangs in the balance; this court should not turn a blind eye to this critical situation by ignoring Congress's constraints to legislate differently for Puerto Rico.[50] Besides being irrational and arbitrary, the exclusion of Puerto Rico's power to authorize its municipalities to request federal bankruptcy relief, should be re-examined in light of more recent rational-basis review case law. In certain cases, where laws have been found to be arbitrary and unreasonable, and where minorities have been specifically targeted for discriminatory treatment, judicial deference—even under such a deferential rational-basis standard—must yield. *See United States v. Windsor*, 133 S. Ct. 2675, 2693 (2013) ("The Constitution's guarantee of equality 'must at the very least mean that a bare congressional desire to harm a politically unpopular group cannot' justify disparate treatment of that group.") (quoting *Dep't of Agric. v. Moreno*, 413 U.S. 528, 534-35 (1973)). Moreover, this Court has recognized that "Supreme Court equal protection decisions have both intensified scrutiny of purported justifications where minorities are subject to discrepant treatment and have limited permissible justification." *Massachusetts v. Dep't of Health & Human Servs.*, 682 F.3d 1, 10 (1st Cir. 2012). "[T]he usually deferential 'rational basis' test has been applied with greater rigor in some contexts, particularly those in which courts have had reason to

---

[50] *See* Maj. Op. 8.

be concerned about possible discrimination." *Id.* at 11 (citing *United States v. Then*, 56 F.3d 464, 468 (2d Cir. 1995) (Calabresi, J., concurring)). Rightly so, because, when facing "historic patterns of disadvantage suffered by the group adversely affected by the statute ... [t]he Court ... undertake [s] a more careful assessment of the justifications than the light scrutiny offered by conventional rational basis review." *Id.* The 1984 Amendments are just another example of a historic pattern of disadvantage suffered by Puerto Rico, but no such careful assessment is performed. *See Igartúa-De La Rosa v. United States*, 626 F.3d 592, 612 (1st Cir. 2010) (Torruella, J., concurring in part, dissenting in part) ("This is a most unfortunate and denigrating predicament for citizens who for more than one hundred years have been branded with a stigma of inferiority, and all that follows therefrom.").

A less-deferential rational basis review should also be performed in light of the aforementioned considerations regarding the well-settled law of Puerto Rico's authority over its internal matters. *See Dep't of Health & Human Servs.*, 682 F.3d at 11-12 ("Supreme Court precedent relating to federalism-based challenges to federal laws reinforce the need for closer than usual scrutiny ... and diminish somewhat the deference ordinarily accorded.").

III. *This Court Now Sends Puerto Ricans to Congress*

The justification for the degree of judicial deference afforded by our constitutional jurisprudence under the typical rational basis review is founded on the basic democratic tenet that, "absent some reason to infer antipathy," courts should not intervene with legislative choices because "even improvident decisions will

eventually be rectified by the democratic process...." *Beach Commc'ns*, 508 U.S. at 314 (quoting *Vance v. Bradley*, 440 U.S. 93, 97 (1979)). And, while the democratic process was equally foreclosed to Puerto Ricans at the time *Harris* and *Califano* were resolved, here the situation is different because, contrary to the Supreme Court's statements in those two cases, we have not been presented with a single plausible explanation of why Congress opted for the disparate treatment of Puerto Rico.

The majority offers Puerto Rico the alternative to seek a political solution in Congress and cites proposed changes in the relevant legislation pending before Congress to show that Puerto Rico is advancing in that direction. While I acknowledge that, in some contexts, the fact that Congress has taken steps to remedy a purportedly unfair statutory distinction may be relevant to avoiding judicial intervention under rational basis review, *see Vance*, 440 U.S. at n.12, when Puerto Rico is effectively excluded from the political process in Congress, this is asking it to play with a deck of cards stacked against it,[51] something

---

[51] Pursuant to the majority's construction of the statutory text, obtaining Congress's authorization to file for Chapter 9 protection would imply a procedure that need not require the enactment of a statute. Regardless of this, Puerto Rico has no political representation in Washington, other than a non-voting member of Congress. *See, e.g., Igartúa-De La Rosa v. United States*, 417 F.3d 145, 159 (1st Cir. 2005) (Torruella, J., dissenting); Juan R. Torruella, *Hacia Dónde Vas Puerto Rico? Puerto Rico*, 107 Yale L.J. 1503, 1519-20 (1998) (reviewing José Trías Monge, *The Trials of the Oldest Colony in the World* (Yale University Press, 1997)) ("[T]hat Puerto Rico has a 'representative' in Congress without a vote is not only a pathetic parody of democracy within the halls of that most democratic of institutions, but also a poignant reminder

this same panel of this court has previously recommended, but to no avail.[52]

IV. *The "Business-as-Usual" Colonial Treatment Continues*

The majority's disregard for the arbitrary and unreasonable nature of the legislation enacted in the 1984 Amendments showcases again this court's approval of a relationship under which Puerto Rico lacks any national political representation in both Houses of Congress and is wanting of electoral rights for the offices of President and Vice-President. That discriminatory relationship allows legislation—such as the 1984 Amendments—to be enacted and applied to the millions of U.S. citizens residing in Puerto Rico without their participation in the democratic process. This is clearly a colonial relationship, one which violates our Constitution and the Law of the Land as established in ratified treaties.[53] Given the vulnerability of these citizens before the political branches of government, it is a special duty of the

---

that Puerto Rico is even more of a colony now than it was under Spain.").

[52] *See Sánchez ex rel. D.R.-S. v. United States*, 671 F.3d 86, 103 (1st Cir. 2012) (stating in dismissing a claim against the United States for injuries caused by the Navy's pollution of Vieques, that "the plaintiffs' pleadings, taken as true, raise serious health concerns. [...] The Clerk of Court is instructed to send a copy of this opinion to the leadership of both the House and Senate."); *see also id.* at 120 (Torruella, J., dissenting) ("Access to the political forum available to most other citizens of the United States has already been blocked by this same Court." (citations omitted)).

[53] *See Igartúa-De La Rosa*, 417 F.3d at 185-86 (Howard, J., dissenting) (questioning the U.S. Senate's declaration that the International Covenant on Civil and Political Rights, ratified by Congress in 1992, is not self-executing).

courts of the United States to be watchful in their defense. As the Supreme Court pronounced, in *United States v. Carolene Products Co.*, 304 U.S. 144, 152 n.4 (1938), "prejudice against ... insular minorities may be a special condition, which tends seriously to curtail the operation of those political processes ordinarily to be relied upon to protect minorities, and which may call for a correspondingly more searching judicial inquiry." I am sorry to say this special duty to perform a "more searching inquiry" has been woefully and consistently shirked by this court when it comes to Puerto Rico, with the majority opinion just being the latest in a series of such examples.[54]

When the economic crisis arose, after considering Congress's cryptic revocation of Puerto Rico's powers to manage its own internal affairs through the 1984 Amendments, Puerto Rico looked elsewhere for a solution. It developed the Recovery Act enacted pursuant to the police powers this very court had sustained, to fill the black hole left by the 1984 Amendments introducing of the definition now codified in § 101(52). And while I agree with the majority that Puerto Rico could not take this step because Chapter 9 applies to Puerto Rico in its entirety, I commend the Commonwealth for seeking ways to resolve its predicament.

---

[54] *See, e.g.*, *Igartúa-De La Rosa*, 626 F.3d at 612; *Igartúa-De La Rosa*, 417 F.3d at 159; *Igartúa-De La Rosa v. United States*, 229 F.3d 80, 85 (1st Cir. 2000) (Torruella, J., concurring); *Lopez v. Aran*, 844 F.2d 898, 910 (1st Cir. 1988) (Torruella, J., concurring in part and dissenting in part); *see also* Juan R. Torruella, *The Insular Cases: A Declaration of Their Bankruptcy and My Harvard Pronouncement* 61 (Gerald L. Neuman and Tomiko Brown-Nagin eds., 2015).

Even if one ignores the uncertain outcome of any proposed legislation, questions still remain: why would Congress intentionally take away a remedy from Puerto Rico that it had before 1984 and leave it at the sole mercy of its creditors? What legitimate purpose can such an action serve, other than putting Puerto Rico's creditors in a position that no other creditors enjoy in the United States? While favoring particular economic interests—*i.e.*, Puerto Rico creditors—to the detriment of three-and-a-half million U.S. citizens, is perhaps "business as usual" in some political circles, one would think it hardly qualifies as a rational constitutional basis for such discriminatory legislation.

V. *Conclusion*

The 1984 Amendments are unconstitutional. Puerto Rico should be free to authorize its municipalities to file for bankruptcy protection under the existing Chapter 9 of the Bankruptcy Code if that is the judgment of its Legislature. I concur in the Judgment.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF PUERTO RICO

FRANKLIN CALIFORNIA TAX-FREE TRUST, *et al.*,

Plaintiffs,

v.

COMMONWEALTH OF PUERTO RICO, *et al.*,

Defendants.

Civil No. 14-1518 (FAB)

BLUEMOUNTAIN CAPITAL MANAGEMENT, LLC,

Plaintiff,

v.

ALEJANDRO J. GARCIA-PADILLA, *et al.*,

Defendants.

Civil No. 14-1569 (FAB)

OPINION AND ORDER

BESOSA, District Judge.

Plaintiffs in these two cases seek a declaratory judgment that the Puerto Rico Public Corporation Debt Enforcement and Recovery Act ("Recovery Act") is unconstitutional. (Civil No. 14-1518, Docket No. 85; Civil No. 14-1569, Docket No. 20.) Before the Court are three motions to dismiss plaintiffs' complaints and one cross-motion for summary judgment.

For the reasons explained below, the Court **GRANTS in part** and **DENIES in part** the three motions to dismiss, (Civil No. 14-1518, Docket Nos. 95 & 97; Civil No. 14-1569, Docket No. 29), and **GRANTS in part and DENIES in part** the cross-motion for summary judgment, (Civil No. 14-1518, Docket No. 78). Because the Recovery Act is preempted by the federal Bankruptcy Code, it is void pursuant to the Supremacy Clause of the United States Constitution.

I. BACKGROUND

Plaintiffs collectively hold nearly two billion dollars of bonds issued by the Puerto Rico Electric Power Authority ("PREPA"). As background for the bases of plaintiffs' claims challenging the constitutionality of the Recovery Act, the Court first summarizes relevant provisions of the PREPA Authority Act (which authorized PREPA to issue bonds), the Trust Agreement (pursuant to which PREPA issued bonds to plaintiffs), the Recovery Act itself, and Chapter 9 of the federal Bankruptcy Code.

A. The Authority Act of May 1941

In May 1941, the Commonwealth of Puerto Rico ("the Commonwealth") enacted the Puerto Rico Electric Power Authority Act ("Authority Act"), P.R. Laws Ann. tit. 22 §§ 191-239, creating PREPA and authorizing it to issue bonds, *id.* §§ 193, 206. Through the Authority Act, the Commonwealth expressly pledged to PREPA bondholders "that it will not limit or alter the rights or powers hereby vested in [PREPA] until all such bonds at any time issued, together with the interest thereon, are fully met and discharged." *Id.* § 215. The Authority Act also expressly gives PREPA bondholders the right to seek the appointment of a receiver if PREPA defaults on any of its bonds. *Id.* § 207.

B. The Trust Agreement of January 1974

PREPA issued the bonds underlying these two lawsuits pursuant to a trust agreement with U.S. Bank National Association as Successor Trustee, dated January 1, 1974, as amended and supplemented through August 1, 2011 ("Trust Agreement"). The Trust Agreement contractually requires PREPA to pay principal and interest on plaintiffs' bonds promptly. Trust Agreement § 701. Plaintiffs' bonds are secured by a pledge of PREPA's present and future revenues, *id.*, and PREPA is prohibited from creating a lien equal to or senior to plaintiffs' lien on these revenues, *id.* § 712. Upon the occurrence of an "event of default," as the term is defined in the Trust Agreement, plaintiff bondholders may accelerate payments, seek the appointment of a receiver "as authorized by the Authority Act," and sue at law or equity to enforce the terms of the Trust Agreement. *Id.* §§ 802-804. An event of default occurs when, among other things, PREPA institutes a proceeding "for the purpose of effecting a composition between [PREPA] and its creditors or for the purpose of adjusting the claims of such creditors pursuant to any federal or Commonwealth statute now or hereafter enacted." *Id.* § 802(g).

C. The Recovery Act of June 2014

On June 25, 2014, the Commonwealth Senate and House of Representatives approved the Recovery Act, and on June 28, 2014, the Governor signed the Recovery Act into law. The Recovery Act's Statement of Motives indicates that Puerto Rico's public corporations, especially PREPA, "face significant operational, fiscal, and financial challenges" and are "burdened with a heavy debt load as compared to the

resources available to cover the corresponding debt service." Recovery Act, Stmt. of Motives, § A. To address this "state of fiscal emergency," the Recovery Act establishes two procedures for Commonwealth public corporations to restructure their debt. *Id.*, Stmt. of Motives, §§ A, E. It also creates the Public Sector Debt Enforcement and Recovery Act Courtroom (hereinafter, "special court") to preside over proceedings and cases brought pursuant to these two procedures. *Id.* § 109(a).

The first restructuring procedure is set forth in Chapter 2 of the Recovery Act and permits an eligible public corporation to seek debt relief from its creditors with authorization from the Government Development Bank for Puerto Rico ("GDB"). Recovery Act § 201(b). The public corporation invoking this approach proposes amendments, modifications, waivers, or exchanges to or of a class of specified debt instruments. *Id.* § 202(a). If creditors representing at least fifty percent of the debt in a given class vote on whether to accept the changes, and at least seventy-five percent of participating voters approve, then the special court may issue an order approving the transaction and binding the entire class. *Id.* §§ 115(b), 202(d), 204.

Chapter 3 of the Recovery Act sets forth the second restructuring approach. Under this approach, an eligible public corporation, again with GDB approval, submits to the special court a petition that lists the amounts and types of claims that will be affected by a restructuring plan. Recovery Act § 301(d). The public corporation then files a proposed restructuring plan or a proposed transfer of the corporation's assets. *Id.* § 310. The special court may confirm the plan if the plan meets certain requirements, *id.* § 315, including a

requirement that "at least one class of affected debt has voted to accept the plan by a majority of all votes cast in such class and two-thirds of the aggregate amount of affected debt in such class that is voted," *id.* § 315(e). The special court's confirmation order binds all of the public corporation's creditors to the restructuring plan. *Id.* § 115(c).

Chapter 2 of the Recovery Act provides for a suspension period and Chapter 3, an automatic stay, during which time creditors may not assert claims or exercise contractual remedies against the public corporation debtor that invokes the Recovery Act. *See* Recovery Act §§ 205, 304.

D. Chapter 9 of the Federal Bankruptcy Code

The Recovery Act is modeled on Title 11 of the United States Code ("the federal Bankruptcy Code"), and particularly on Chapter 9 of that title. Recovery Act, Stmt. of Motives, § E. Chapter 9 governs the adjustment of debts of a municipality, 11 U.S.C. §§ 901 *et seq.*, and "municipality" includes a public agency or instrumentality of a state, *id.* § 101(40). A municipality seeking to adjust its debts pursuant to Chapter 9 must receive specific authorization from its state. *Id.* § 109(c)(2). Puerto Rico municipalities are expressly prohibited from seeking debt adjustment pursuant to Chapter 9. *Id.* § 101(52).

II. THE PRESENT LITIGATION

A. Franklin and Oppenheimer Rochester Plaintiffs' Second Amended Complaint (Civil No. 14-1518)

Franklin plaintiffs[1] are Delaware corporations or trusts that collectively hold approximately $692,855,000 of PREPA bonds. (Civil No. 14-1518, Docket No. 85 at ¶ 3.) Oppenheimer Rochester plaintiffs[2] are Delaware statutory trusts that hold

---

[1] The Court refers to the following parties collectively as "Franklin plaintiffs": Franklin California Tax-Free Trust (for the Franklin California Intermediate-Term Tax Free Income Fund), Franklin Tax-Free Trust (for the series Franklin Federal Intermediate-Term Tax-Free Income Fund, Franklin Double Tax-Free Income Fund, Franklin Colorado Tax-Free Income Fund, Franklin Georgia Tax-Free Income Fund, Franklin Pennsylvania Tax-Free Income Fund, Franklin High Yield Tax-Free Income Fund, Franklin Missouri Tax-Free Income Fund, Franklin Oregon Tax-Free Income Fund, Franklin Virginia Tax-Free Income Fund, Franklin Florida Tax-Free Income Fund, Franklin Louisiana Tax-Free Income Fund, Franklin Maryland Tax-Free Income Fund, Franklin North Carolina Tax-Free Income Fund, and Franklin New Jersey Tax-Free Income Fund), Franklin Municipal Securities Trust (for the series Franklin California High Yield Municipal Bond Fund and Franklin Tennessee Municipal Bond Fund), Franklin California Tax-Free Income Fund, Franklin New York Tax-Free Income Fund, and Franklin Federal Tax-Free Income Fund.

[2] The Court refers to the following parties collectively as "Oppenheimer Rochester plaintiffs": Oppenheimer Rochester Fund Municipals, Oppenheimer Municipal Fund (on behalf of its series Oppenheimer Rochester Limited Term Municipal Fund), Oppenheimer Multi-State Municipal Trust (on behalf of its series Oppenheimer Rochester New Jersey Municipal Fund, Oppenheimer Rochester Pennsylvania Municipal Fund and Oppenheimer Rochester High Yield Municipal Fund), Oppenheimer Rochester Ohio Municipal Fund, Oppenheimer Rochester Arizona Municipal Fund, Oppenheimer Rochester

approximately $866,165,000 of PREPA bonds. *Id.* at ¶ 4. On August 11, 2014, the Franklin and Oppenheimer Rochester plaintiffs filed a second amended complaint against the Commonwealth of Puerto Rico, Alejandro Garcia-Padilla (in his official capacity as Governor of Puerto Rico), Melba Acosta (in her official capacity as a GDB agent), and PREPA. (Civil No. 14-1518, Docket No. 85.) The Franklin and Oppenheimer Rochester plaintiffs seek declaratory relief on the following claims: (1) *Preemption:* that the Recovery Act in its entirety is preempted by section 903 of the federal Bankruptcy Code and violates the Bankruptcy Clause of the United States Constitution; (2) *Contract Clause:* that sections 108, 115, 202, 312, 315, and 325 of the Recovery Act violate the Contract Clause of the United States Constitution by impairing the contractual obligations imposed by the Authority Act and the Trust Agreement; (3) *Takings Clause:* that the Recovery Act violates the Takings Clause of the United States Constitution by taking without just compensation plaintiffs' contractual right to seek the appointment of a receiver, *see* Recovery Act § 108(b), and plaintiffs' lien on PREPA revenues, *see id.* §§ 129(d), 322(c); and (4) *Stay of Federal Court Proceedings:* that section 304 of the Recovery Act

---

Virginia Municipal Fund, Oppenheimer Rochester Maryland Municipal Fund, Oppenheimer Rochester Limited Term California Municipal Fund, Oppenheimer Rochester California Municipal Fund, Rochester Portfolio Series (on behalf of its series Oppenheimer Rochester Limited Term New York Municipal Fund), Oppenheimer Rochester AMT-Free Municipal Fund, Oppenheimer Rochester AMT-Free New York Municipal Fund, Oppenheimer Rochester Michigan Municipal Fund, Oppenheimer Rochester Massachusetts Municipal Fund, Oppenheimer Rochester North Carolina Municipal Fund, and Oppenheimer Rochester Minnesota Municipal Fund.

unconstitutionally authorizes a stay of federal court proceedings when a public corporation files for debt relief pursuant to the Recovery Act. (Civil No. 14-1518, Docket No. 85 at ¶¶ 58-71.)

B. Franklin and Oppenheimer Rochester Plaintiffs' Cross-Motion for Summary Judgment

On August 11, 2014, the Franklin and Oppenheimer Rochester plaintiffs filed a cross-motion for summary judgment on their preemption and stay of federal court proceedings claims (while opposing original motions to dismiss). (Civil No. 14-1518, Docket No. 78.)

C. Plaintiff BlueMountain's Amended Complaint (Civil No. 14-1569)

BlueMountain Capital Management, LLC (for itself and for and on behalf of investment funds for which it acts as investment manager) ("BlueMountain") is a Delaware company that holds PREPA bonds and that manages funds that hold more than $400,000,000 of PREPA bonds. (Civil No. 14-1569, Docket No. 20 at ¶ 6.) On August 12, 2014, BlueMountain filed an amended complaint against Alejandro Garcia-Padilla (in his official capacity as Governor of Puerto Rico), Cesar R. Miranda Rodriguez (in his official capacity as the Attorney General of Puerto Rico), and John Doe (in his official capacity as a GDB agent). (Civil No. 14-1569, Docket No. 20.) Plaintiff BlueMountain seeks declaratory relief on the following claims: (1) *Preemption:* that the Recovery Act in its entirety is preempted by the federal Bankruptcy Code and violates the Bankruptcy Clause of the United States Constitution; (2) *Contract Clauses:* that the Recovery Act impairs the contractual obligations imposed by the

Authority Act and the Trust Agreement and therefore violates the contract clauses of the United States and Puerto Rico constitutions; and (3) *Stay of Federal Court Proceedings:* that sections 205 and 304 of the Recovery Act unconstitutionally authorize a stay of federal court proceedings when a public corporation files for debt relief pursuant to the Recovery Act. (Civil No. 14-1569, Docket No. 20 at ¶ 83.)

D. Consolidation Order

On August 20, 2014, tins Court consolidutoci Civil Case Nos. 14-1518 and 14-1569. In so doing, the Court aligned the briefing schedules for both cases but did not merge the suits into a single cause of action or change the rights of the parties. (Civil No. 14-1518, Docket No. 92; Civil No. 14-1569, Docket No. 26.)

The two cases contain overlapping claims but are distinct in three salient ways. First, the Franklin and Oppenheimer Rochester plaintiffs bring suit against Commonwealth defendants and PREPA (in Civil No. 14-1518), whereas BlueMountain names only Commonwealth defendants (in Civil No. 14-1569). Second, only the Franklin and Oppenheimer Rochester plaintiffs raise a Takings Clause claim. Third, only BlueMountain brings a Puerto Rico Constitution Contract Clause claim.

E. Commonwealth and PREPA Motions to Dismiss

On September 12, 2014, the Commonwealth defendants[3] moved to dismiss the Franklin and

---

[3] The following parties are collectively referred to as the "Commonwealth defendants": the Commonwealth of Puerto Rico, Alejandro Garcia-Padilla (in his official capacity as Governor of Puerto Rico), Cesar R. Miranda Rodriguez (in his official capacity

Oppenheimer Rochester plaintiffs' second amended complaint and BlueMountain's amended complaint, and opposed the Franklin and Oppenheimer Rochester plaintiffs' cross-motion for summary judgment. (Civil No. 14-1518, Docket No. 95, mem. at Docket No. 95-1; Civil No. 14-1569, Docket No. 29, mem. at Docket No. 29-1.)[4] The Commonwealth defendants argue that plaintiffs' claims are unripe and fail on the merits as a matter of law.

PREPA joined the Commonwealth defendants' motion to dismiss the Franklin and Oppenheimer Rochester plaintiffs' second amended complaint and opposition to the cross-motion for summary judgment. (Civil No. 14-1518, Docket No. 97 at p. 1.) PREPA also filed its own motion to dismiss, arguing that the Franklin and Oppenheimer Rochester plaintiffs lack standing and that their claims are unripe. (Civil No. 14-1518, Docket No. 97.)

The Franklin and Oppenheimer Rochester plaintiffs opposed the Commonwealth defendants' motion and PREPA's motion, (Civil No. 14-1518, Docket No. 102), and BlueMountain opposed the Commonwealth defendants' motion, (Civil No. 14-1569, Docket No. 41). The Commonwealth defendants replied, (Civil No. 14-1518, Docket No. 108; Civil No. 14-1569, Docket No.

---

as Attorney General of Puerto Rico), Melba Acosta (in her official capacity as a GDB agent), and John Doe (in his official capacity as a GDB agent).

[4] These two memoranda are identical. *Compare* Civil No. 14-1518, Docket No. 95-1, *with* Civil No. 14-1569, Docket No. 29-1. That is, the Commonwealth defendants raised identical arguments in moving to dismiss the Franklin and Oppenheimer Rochester plaintiffs' second amended complaint and BlueMountain's amended complaint.

44),[5] as did PREPA (Civil No. 14-1518, Docket No. 109).

III. SUBJECT MATTER JURISDICTION

Defendants challenge the Court's subject matter jurisdiction and seek dismissal pursuant to Federal Rule of Civil Procedure 12(b)(1) ("Rule 12(b)(1)"). Defendants argue that plaintiffs' claims are unripe because PREPA has not sought to restructure its debt pursuant to the Recovery Act. Therefore, defendants argue, plaintiffs have no basis to claim that the Recovery Act injured plaintiffs in their capacity as PREPA bondholders. (Civil No. 14-1518, Docket No. 95-1 at pp. 8-13; Civil No. 14-1569, Docket No. 29-1 at pp. 8-13.) In addition to this ripeness argument, defendant PREPA argues separately that the Franklin and Oppenheimer Rochester plaintiffs lack standing. (Civil No. 14-1569, Docket No. 97 at pp. 5-14.)

A. Rule 12(b)(1) Motion to Dismiss Standard

Pursuant to Rule 12(b)(1), a defendant may seek dismissal of claims by asserting that the Court lacks subject matter jurisdiction. Fed. R. Civ. P. 12(b)(1). The plaintiffs bear "the burden of clearly alleging definite facts to demonstrate thai jurisdiction is proper." *Nulankeyutmonen Nkihtaqmikon v. Impson*, 503 F.3d 18, 25 (1st Cir. 2007). The Court accepts as true the well-pled factual allegations in the plaintiffs' complaints and makes all reasonable inferences in the plaintiffs' favor. *Downing/Salt Pond Partners, L.P. v. Rhode Island & Providence Plantations*, 643 F.3d 16, 17 (1st Cir. 2011). On a Rule 12(b)(1) motion, the Court may consider materials outside the pleadings to

---

[5] These two memoranda are identical. *Compare* Civil No. 14-1518, Docket No. 108, *with* Civil No. 14-1569, Docket No. 44.

determine jurisdiction. *Gonzalez v. United States*. 284 F.3d 281, 288 (1st Cir. 2002).

B. Ripeness

The ripeness doctrine "has roots in both the Article III case or controversy requirement and in prudential considerations." *Mangual v. Rotger-Sabat*, 317 F.3d 45, 59 (1st Cir. 2003). "The 'basic rationale' of the ripeness inquiry is 'to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements.'" *Roman Catholic Bishop of Springfield v. City of Springfield*, 724 F.3d 78, 89 (1st Cir. 2013) (quoting *Abbott Labs. v. Gardner*, 387 U.S. 136, 148 (1967)). The ripeness test has two prongs: "'the fitness of the issues for judicial decision' and the hardship to the parties of withholding court consideration.'" *Pac. Gas & Elec. Co. v. State Energy Res. Conservation & Dev. Comm'n*, 461 U.S. 190, 201 (1983) (quoting *Abbott Labs.*, 387 U.S. at 149). Both the fitness and hardship prongs of this test "must be satisfied, although a strong showing on one may compensate for a weak one on the other." *McInnis-Misenor v. Maine Med. Ctr.*, 319 F.3d 63, 70 (1st Cir. 2003).

The First Circuit Court of Appeals has repeatedly cautioned that ripeness inquiries are "highly fact-dependent, such that the 'various integers that enter into the ripeness equation play out quite differently from case to case.'" *Verizon New England, Inc. v. Int'l Bhd. of Elec. Workers, Local No. 2322*, 651 F.3d 176, 188 (1st Cir. 2011) (quoting *Doe v. Bush*, 323 F.3d 133, 138 (1st Cir. 2003) (quoting *Ernst & Young v. Depositors Econ. Prot. Corp.*, 45 F.3d 530, 535 (1st Cir. 1995))).

1. Plaintiffs' Preemption and Contract Clauses Claims Are Ripe

As discussed below, the Court concludes that plaintiffs' preemption and contract clauses claims are fit for review, and that withholding judgment on these claims will impose hardship.

a) Fitness

"The fitness prong of the ripeness test has both constitutional and prudential components." *Roman Catholic Bishop of Springfield*, 724 F.3d at 89. The constitutional component is "grounded in the prohibition against advisory opinions" and "concerns whether there is a sufficiently live case or controversy, at the time of the proceedings, to create jurisdiction in the federal courts." *Id.* (internal quotation marks and citations omitted). A sound way to determine constitutional fitness is to "evaluate the nature of the relief requested; [t]he controversy must be such that it admits of 'specific relief through a decree of conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.'" *Rhode Island v. Narragansett Indian Tribe*, 19 F.3d 685, 693 (1st Cir. 1994) (quoting *Aetna Life Ins. Co. of Hartford, Conn. v. Haworth*, 300 U.S. 227, 241 (1937)).

Texas v. United States, 523 U.S. 296 (1998), provides a prime example of an unfit case where the plaintiff seeks an opinion advising what the law would be in a hypothetical scenario. In that case, the Texas Education Code permitted the imposition of ten possible sanctions if a school district failed the state's accreditation criteria. *Texas*, 523 U.S. at 298. The State of Texas sought a declaratory judgment that the Voting Rights Act "under no circumstances" would

apply to the imposition of two of these sanctions. *Id.* at 301. The sanctions, however, were never imposed. *Id.* at 298. Thus, the circumstances under which the sanctions could be imposed were entirely hypothetical and speculative. As to the fitness inquiry, the United States Supreme Court concluded that it would not employ its "powers of imagination" and that the operation of the sanction provisions would be "better grasped when viewed in light of a particular application." *Id.* at 301; *see Int'l Longshoremen's & Warehousemen's Union. Local 37 v. Boyd*, 347 U.S. 222, 224 (1954) ("Determination of the scope ... of legislation in advance of its immediate adverse effect in the context of a concrete case involves too remote and abstract an inquiry for the proper exercise of the judicial function.").

Here, plaintiffs' preemption and contract clauses claims rely on the *enactment* of the Recovery Act, not on its *application*. Plaintiffs do not seek a declaration that the Recovery Act *would be preempted* if enforced in a hypothetical way. Nor do plaintiffs seek a declaration that the Recovery Act *would impair contractual obligations* if applied in a hypothetical scenario. Rather, the relief plaintiffs seek—a declaration that the Recovery Act is unconstitutional because federal law preempts it and because the Contracts Clause prohibits it—is conclusive in character, not dependant on hypothetical facts, and completely unlike the advisory opinion sought in *Texas*.

The prudential component of the fitness prong considers "the extent to which resolution of the challenge depends upon facts that may not yet be sufficiently developed." *Ernst & Young*, 45 F.3d at 535.

Accordingly, cases "intrinsically legal nature" are likely to be found fit. *Riva v. Massachusetts*, 61 F.3d 1003, 1010 (1st Cir. 1995); *see Thomas v. Union Carbide Agr. Products Co.*, 473 U.S. 568, 581 (1985) (claim that a law violated Article III of the Constitution was fit for review because it was "purely legal, and [would] not be clarified by further factual development"). Courts are also likely to find cases fit when "all of the acts that are alleged to create liability have already occurred." *Verizon New England*, 651 F.3d at 189 (quotation marks and citation omitted); *see Roman Catholic Bishop of Springfield*, 724 F.3d at 91-93 (dismissing claims that rely on a potential future application of an ordinance as unfit for review, but holding that the claims that "rest solely on the existence of the Ordinance" are fit for review because "no further factual development is necessary"); *Pustell v. Lynn Pub. Sch.*, 18 F.3d 50, 52 (1st Cir. 1994) (finding constitutional challenge fit where "[n]o further factual development [was] necessary for [the court] to resolve the question at issue").

The issues presented in plaintiffs' preemption claims are purely legal: the Court need not consider any fact to determine whether the Recovery Act, on its face, is preempted by federal law. Plaintiffs' contract clauses claims involve two limited factual inquiries: (1) whether the enactment of the Recovery Act substantially impaired the contractual relationships created in the Authority Act and the Trust Agreement, and (2) whether the enactment of the Recovery Act was "reasonable and necessary to serve an important public purpose." *See infra* Part V. Both of these inquiries involve solely acts that occurred and facts that existed at or before the Recovery Act's enactment in June

2014. Thus, plaintiffs' contract clauses claims do not require further factual development.

The Court therefore finds that plaintiffs' preemption and contract clauses claims are fit for review.

b) Hardship

The hardship prong of the ripeness test evaluates whether "the impact" of the challenged law upon the plaintiffs is "sufficiently direct and immediate as to render the issue appropriate for judicial review." *Abbott Labs.*, 387 U.S. at 152. This inquiry should also "focus on the judgment's usefulness" and consider "whether granting relief would serve a useful purpose, or, put another way, whether the sought-after declaration would be of practical assistance in setting the underlying controversy to rest." *Rhode Island*, 19 F.3d at 693; *accord Verizon New England*, 651 F.3d at 188.

Plaintiffs allege that the enactment of the Recovery Act totally eliminated several remedial and security rights promised to them in the Authority Act and in the Trust Agreement. First, in the Authority Act, the Commonwealth expressly pledged that it would not alter PREPA's rights until all bonds are fully satisfied and discharged. P.R. Laws Ann. tit. 22 § 215.[6]

---

[6] The Authority Act provides as follows:

> The Commonwealth Government does hereby pledge to, and agree with, any person, firm or corporation, or any federal, Commonwealth or state agency, subscribing to or acquiring bonds of [PREPA] to finance in whole or in part any undertaking or any part thereof, that it will not limit or alter the rights or powers hereby vested in [PREPA] until all such

Plaintiffs allege that the Recovery Act eliminates this guarantee by giving PREPA the right to participate in a new legal regime to restructure its debts. Second, section 17 of the Authority Act grants bondholders the right to seek appointment of a receiver if PREPA defaults. P.R. Laws Ann. tit. 22 § 207. This right is incorporated into section 804 of the Trust Agreement, which guarantees that bondholders have the right to seek "the appointment of a receiver as authorized by the Authority Act" if PREPA defaults. Trust Agreement § 804. Plaintiffs allege that the Recovery Act expressly eliminates the right to seek the appointment of a receiver. *See* Recovery Act § 108(b).[7] Third, the Trust Agreement includes a guarantee that PREPA will not create a lien equal to or senior to the lien on PREPA's revenues that secures plaintiffs' bonds. Trust Agreement § 712. Plaintiffs allege that the Recovery Act eliminates this guarantee by permitting PREPA to obtain credit secured by a lien that is senior to plaintiffs' lien. *See* Recovery Act §§ 129(d), 206(a), 322(c).[8] Fourth, in the event of

---

> bonds at any time issued, together with the interest thereon, are fully met and discharged.

P.R. Laws Ann. tit. 22 § 215.

[7] "This Act supersedes and annuls any insolvency or custodial provision included in the enabling or other act of any public corporation, including Section 17 of [the Authority Act]." Recovery Act § 108(b).

[8] Section 322(c) of the Recovery Act permits the special court to authorize public corporations that seek debt relief pursuant to Chapter 3 to obtain credit "secured by a senior or equal lien on the petitioner's property that is subject to a lien only if—(1) the petitioner is unable to obtain such credit otherwise; and (2) either (A) the proceeds are needed to perform public functions and satisfy the requirements of section 128 of this Act; or (B) there is adequate protection of the interest of the holder of the lien on the

default, the Trust Agreement gives PREPA bondholders the right to accelerate payments. Trust Agreement § 803. Plaintiffs allege that the Recovery Act destroys their right to this remedy both during the suspension and stay provisions, Recovery Act §§ 205, 304, and after the special court approves a plan pursuant to Chapter 2 or 3, *id.* §§ 115(b)(2), 115(c)(3).[9]

---

property of the petitioner on which such senior or equal lien is proposed to be granted." Recovery Act § 322(c). This right extends to corporations seeking debt relief pursuant to Chapter 2 of the Recovery Act. *See id.* § 206(a) ("After the commencement of the suspension period, an eligible obligor may obtain credit in the same manner and on the same terms as a petitioner pursuant to section 322 of this Act.") Section 129(d) of the Recovery Act disposes of the "adequate protection" requirement in section 322(c)(2)(B) when "police power" justifies it. *Id.* § 129(d).

[9] Section 205 prohibits bondholders from exercising remedies during Chapter 2's suspension period. Recovery Act § 205 ("Notwithstanding any contractual provision or applicable law to the contrary, during the suspension period, no entity asserting claims or other rights, ... in respect of affected debt instruments ... may exercise or continue to exercise any remedy under a contract or applicable law ... that is conditioned upon the financial condition of, or the commencement of a restructuring, insolvency, bankruptcy, or other proceedings (or a similar or analogous process) by, the eligible obligor concerned, including a default or an event of default thereunder."). Section 304 stays "any act to collect, assess, or recover on a claim against the petitioner" during Chapter 3's automatic stay period. *Id.* § 304.

Section 115 prohibits bondholders from exercising remedies after the special court approves a plan pursuant to Chapter 2 or 3. *Id.* § 115(b)(2) ("Upon entry of an approval order ... under chapter 2 of this Act ... no entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments of such eligible obligor ... shall bring any action or proceeding of any kind or character for the enforcement of such claim or remedies in respect of such affected debt instruments, except with the permission of the [special court] and then only to recover and enforce the rights permitted under the amendments,

Fifth, the Trust Agreement contains an *ipso facto* clause that provides that PREPA is deemed in default if PREPA institutes a proceeding "for the purpose of effecting a composition between [PREPA] and its creditors or for the purpose of adjusting the claims of such creditors." Trust Agreement § 802(g). Plaintiffs allege that the Recovery Act explicitly renders this *ipso facto* clause unenforceable in a section titled "Unenforceable Ipso Facto Clauses." *See* Recovery Act § 325(a); *see also id.* § 205(c).[10]

---

modifications, waivers, or exchanges, and the approval order."); *id.* § 115(c)(3) ("[U]pon entry of a confirmation order, ... all creditors affected by the plan ... shall be enjoined from, directly or indirectly, taking any action inconsistent with the purpose of this Act, including bringing any action or proceeding of any kind or character for the enforcement of such claim or remedies in respect of affected debt, except as each has been affected pursuant to the plan under chapter 3.").

[10] Section 325 of the Recovery Act provides as follows in its first subsection:

> Notwithstanding any contractual provision or applicable law to the contrary, a contract of a petitioner may not be terminated or modified, and any right or obligation under such contract may not be terminated or modified, at any time after the filing of a petition under chapter 3 of this Act solely because of a provision in such contract conditioned on:
>
> (1) the insolvency or financial condition of the petitioner at any time before the closing of the case;
>
> (2) the filing of a petition pursuant to section 301 of this Act and all other relief requested under this Act; or
>
> (3) a default under a separate contract that is due to, triggered by, or as a result of the occurrence of the events or matters in subsections (a)(1) [the

The Commonwealth's nullification of this series of statutory and contractual security rights and remedial provisions, through its enactment of the Recovery Act, is a "direct and immediate" injury to the plaintiff bondholders. *See Abbott Labs.*, 387 U.S. at 152. Plaintiffs should not be forced to live with such substantially impaired contractual rights—rights that they bargained for when they purchased the nearly two billion dollars worth of PREPA bonds that they hold collectively.

This hardship is certainly more immediate and concrete than the "threat to federalism" hardship that the plaintiff alleged in *Texas*, which the Supreme Court viewed as an "abstraction" that was "inadequate to support suit unless the [plaintiff's] primary conduct is affected." 523 U.S. at 302. Here, not having the guarantee of remedial provisions that they were promised affects plaintiffs' day-to-day business as PREPA bondholders, particularly when negotiating with PREPA over remedies and potential restructuring. Indeed, the threat of PREPA's invocation of the Recovery Act hangs over plaintiffs and diminishes their bargaining power as bondholders. *Sec Metro. Wash. Airports Auth. v. Citizens for Abatement of Aircraft Noise, Inc.*, 501 U.S. 252, 265 n.13 (1991) (concluding that constitutional challenge to "veto power" of administrative board was ripe "even if the veto power has not been exercised to respondents'

---

petitioner's insolvency] or (a)(2) [the filing of a Chapter 3 petition] of this section.

Recovery Act § 325(a). Section 205(c) of the Recovery Act has nearly identical language and renders *ipso facto* clauses unenforceable during the suspension period of a Chapter 2 proceeding. *Id.* § 205(c).

detriment" because the "threat of the veto hangs over the [decisionmakers subject to the veto] like the sword over Damocles, creating a 'here-and-now subservience'" to the administrative board).

In addition, plaintiffs' sought-after declaration that the Recovery Act is unconstitutional would "be of practical assistance in setting the underlying controversy to rest" because it would completely restore plaintiffs' contractual rights. *See Rhode Island*, 19 F.3d at 693. In this sense, the hardship here is unlike the hardship in *Ernst & Young*, 45 F.3d 530. In that case, the plaintiff alleged that a Rhode Island law limiting nonsettling tortfeasors' right of contribution against joint tortfeasors caused two hardships: increased pressure to settle a negligence suit and an inability to evaluate its exposure therein. 45 F.3d at 532-33, 539. The First Circuit Court of Appeals, in holding the claim unripe, reasoned that resolving the challenge to the Rhode Island law would be of "limited utility" to the plaintiff because (1) the plaintiff would still be faced with the negligence suit, and (2) the right to contribution was only one of many factors involved in the plaintiff's settlement calculations. *Id.* at 540 (explaining that "the usefulness that may satisfy the hardship prong ... is not met by a party showing that it has the opportunity to move from a position of utter confusion to one of mere befuddlement"). Here, the declaration that plaintiffs seek on their preemption and contract clauses claims—that the Recovery Act in its entirety is unconstitutional—would be of great utility to plaintiffs because it would completely restore their rights guaranteed in the Authority Act and the Trust Agreement.

In sum, delaying adjudication on the merits of plaintiffs' constitutional claims until PREPA invokes the Recovery Act—the event that the Commonwealth defendants concede would render plaintiffs' challenges ripe, (Civil No. 14-1518, Docket No. 95-1 at pp. 1, 12-13)—would continue to inflict hardship on plaintiffs with no identifiable corresponding gain. Thus, having satisfied the fitness and hardship prongs of the ripeness test, the Court concludes that plaintiffs' preemption and contract clauses claims are ripe for review.

2. Plaintiffs' Stay of Federal Court Proceedings Claims Are Not Ripe

Plaintiffs seek a declaratory judgment that the Recovery Act violates the United States Constitution to the extent that section 304 of the Act authorizes a stay of federal court proceedings when a public corporation files for debt relief. (Civil No. 14-1518, Docket No. 85 at ¶¶ 55, 69; Civil No. 14-1569, Docket No. 20 at ¶¶ 76, 83(d).) Plaintiff BlueMountain additionally claims that section 205 of the Recovery Act unconstitutionally authorizes a suspension of federal court proceedings. (Civil No. 14-1569, Docket No. 20 at ¶¶ 76, 83(d).) Plaintiffs do not identify a specific provision of the Constitution that these provisions violate, but rather rely on the United States Supreme Court holding in *Donovan v. City of Dallas*, 377 U.S. 408, 413 (1964), that "state courts are completely without power to restrain federal-court proceedings in in personam actions."

First, as to the claims' fitness, the Court evaluates whether plaintiffs are requesting "specific relief through a decree of conclusive character" as opposed to "an opinion advising what the law would be upon a

hypothetical state of facts." *Rhode Island*, 19 F.3d at 693 (quoting *Aetna Life Ins. Co.*, 300 U.S. at 241). The following language in plaintiffs' complaint reveals that they seek the latter:

> To the extent any provision of the [Recovery Act] enjoins, stays, suspends or precludes [plaintiffs] from exercising their rights in federal court, including their right to challenge the constitutionality of the Recovery Act itself in federal court, those provisions also violate the Constitution.

(Civil No. 14-1518, Docket No. 85 at ¶ 57; Civil No. 14-1569, Docket No. 20 at ¶ 77.) Plaintiffs essentially seek an opinion that *certain applications* of the suspension and stay provisions of the Recovery Act would be unconstitutional. The Court finds that this request is akin to the relief sought in *Texas*, and that the operation of sections 304 and 205 of the Recovery Act would be "better grasped when viewed in light of a particular application." *Texas*, 523 U.S. at 301.

Second, as to the prudential component of the fitness prong, the "remoteness and abstraction" of plaintiffs' pre-enforcement injury is "increased by that fact that [the suspension and stay provisions have] yet to be interpreted by the [Puerto Rico] courts." *See Texas*, 523 U.S. at 301. Thus, "'[p]ostponing consideration of the questions presented, until a more concrete controversy arises, also has the advantage of permitting the state courts further opportunity to construe' the provisions," and indeed to construe them in a constitutional way. *See id.* (quoting *Renne v. Geary*, 501 U.S. 312, 323 (1991)).

Finally, concerning the hardship prong, the Court examines whether withholding judgment on the stay of

federal court proceedings claims would create a "direct and immediate dilemma for the parties." *See Stern v. U.S. Dist. Court for Dist. of Mass.*, 214 F.3d 4, 10 (1st Cir. 2000). Because PREPA has not filed for debt relief pursuant to the Recovery Act, the suspension period and automatic stay in sections 205 and 304 of the Recovery Act have not been triggered. Thus, plaintiffs do not allege that any actual application of the suspension or stay provisions has injured them. The Court therefore turns to whether the enactment of these provisions causes a direct injury. Enactment of the suspension and stay provisions appears to impair plaintiffs' contractual right to sue to enforce the terms of the Trust Agreement, *see* Trust Agreement § 804, which does impose hardship on plaintiffs. But this showing of hardship is weak—much weaker than the hardship created by the nullification of the series of rights that supported jurisdiction of plaintiffs' preemption and contract clauses claim.

Thus, plaintiffs' stay of federal court proceedings claims fail the fitness prong and has a weak showing on the hardship prong of the ripeness test. The Court therefore concludes that these claims are unripe and **GRANTS** the Commonwealth defendants' motions to dismiss, (Civil No. 14-1518, Docket No. 95; Civil No. 14-1569, Docket No. 29), as to the stay of federal court proceedings claims.

C. Standing

The doctrines of ripeness and standing overlap in many ways. *McInnis-Misenor*, 319 F.3d at 71. Standing, like ripeness, has roots in Article III's case or controversy requirement. *See* U.S. Const. Art. III, § 2. To establish constitutional standing, a plaintiff must satisfy three elements: "a concrete and particularized

injury in fact, a causal connection that permits tracing the claimed injury to the defendant's actions, and a likelihood that prevailing in the action will afford some redress for the injury." *Weaver's Cove Energy, LLC v. R.I. Coastal Res. Mgmt. Council*, 589 F.3d 458, 467 (1st Cir. 2009) (internal quotation marks and citations omitted).

Plaintiffs meet these three elements as to their preemption and contract clauses claims against the Commonwealth defendants. First, as discussed above, the Recovery Act's nullification of several statutory and contractual security rights is a direct injury to the plaintiff bondholders.[11] Second, this injury was caused by the Commonwealth's enactment of the Recovery Act. Third, plaintiffs' desired declaratory judgment that the Recovery Act is unconstitutional will afford plaintiffs redress for the injury because it will nullify the Recovery Act, restoring plaintiffs' statutory and contractual rights.

As to the Franklin and Oppenheimer Rochester plaintiffs' claims against PREPA, however, the second element of the standing test is not met: the elimination of plaintiffs' security rights is traceable only to the Commonwealth's enactment of the Recovery Act and not to any action by PREPA. If PREPA's filing for debt relief pursuant to the Recovery Act were imminent, this could be a sufficient injury traceable to PREPA. *See Katz v. Pershing, LLC*, 672 F.3d 64, 71 (1st Cir. 2012) (explaining that an "imminent injury" can satisfy the standing injury-in-fact requirement if the harm is "sufficiently threatening, " but that "it is not enough that the harm might occur at some future time"). To

---

[11] *See supra* Part III.B.1.b.

support their allegation that PREPA will file for relief pursuant to the Recovery Act imminently, plaintiffs point to (1) the Recovery Act's Statement of Motives, which identifies PREPA as the "most dramatic example" of a Commonwealth public corporation that faces significant financial challenges, and (2) market watchers' predications from July 2014 that it is highly likely that PREPA will seek relief pursuant to the Recovery Act in the near future. (Civil No. 14-1518, Docket No. 85 at ¶¶ 18-19.) Without more, these two factual allegations merely support speculation that PREPA will file for relief at some future time; they do not support the conclusion that the filing is imminent.

Accordingly, because the Franklin and Oppenheimer Rochester plaintiffs have not sufficiently alleged any injury traceable to an action by PREPA, they lack standing to assert their claims against PREPA. The Court therefore **GRANTS** PREPA's motion to dismiss, (Civil No. 14-1518, Docket No. 97), as to all claims to the extent that they are asserted against PREPA, and **DISMISSES** PREPA from Civil Case No. 14-1518.

The Court proceeds to the merits of plaintiffs' preemption and contract clauses claims. The Court will then address the ripeness and merits of the Franklin and Oppenheimer Rochester plaintiffs' Takings Clause claim.

IV. PREEMPTION

Plaintiffs seek a declaratory judgment that the Recovery Act in its entirety is preempted by the federal Bankruptcy Code and violates the Bankruptcy Clause of the United States Constitution. (Civil No. 14-1518, Docket No. 85 at ¶ 59; Civil No. 14-1569, Docket No. 20 at ¶ 83(a).) The Commonwealth defendants move to

dismiss, (Civil No. 14-1518, Docket No. 95; Civil No. 14-1569, Docket No. 29), and the Franklin and Oppenheimer Rochester plaintiffs cross-move for summary judgment, (Civil No. 14-1518, Docket No. 78). The Court first addresses the appropriate standard of review and then discusses the merits of plaintiffs' preemption claims.

A. Rule 12(b) (6) Motion to Dismiss and Rule 56(a) Motion for Summary Judgment Standards

The Commonwealth defendants' motions to dismiss are governed by Federal Rule of Civil Procedure 12(b)(6) ("Rule 12(b)(6)"). *See* Fed. R. Civ. P. 12(b)(6). Pursuant to Rule 12(b)(6), the Court construes the well-pleaded facts in the plaintiffs' complaints in the light most favorable to the plaintiffs and will dismiss the complaints if they fail to state a plausible legal claim upon which relief can be granted. *Ocasio-Hernandez v. Fortuño-Burset*, 640 F.3d 1, 7, 12-13 (1st Cir. 2011).

The Franklin and Oppenheimer Rochester plaintiffs' motion for summary judgment is governed by Federal Rule of Civil Procedure 56. *See* Fed. R. Civ. P. 56. The Court will grant summary judgment if plaintiffs show "that there is no genuine dispute as to any material fact" and that they are "entitled to judgment as a matter of law." *Id.*

The parties agree that the preemption claim is purely legal and involves no disputed issues of material fact. (Civil No. 14-1518, Docket Nos. 79 at p. 7 & 95-2 at pp. 1-2.) The Court therefore resolves the preemption issues presented in the parties' motions as ones of law.

B. Preemption Principles

The Supremacy Clause of the United States Constitution mandates that federal law "shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const, art. VI, cl. 2. Pursuant to this mandate, "Congress has the power to preempt state law," *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000), and a "state law that contravenes a federal law is null and void," *Tobin v. Fed. Exp. Corp.*, No. 14-1567, 2014 WL 7388805, at *4 (1st Cir. Dec. 30, 2014). "For preemption purposes, the laws of Puerto Rico are the functional equivalent of state laws." *Antilles Cement Corp. v. Fortuño*, 670 F.3d 310, 323 (1st Cir. 2012).

A federal statute can preempt a state law in three ways: express preemption, conflict preemption, and field preemption. *Arizona v. United States*, 132 S. Ct. 2492, 2500-01 (2012). Here, plaintiffs raise arguments pursuant to all three.

C. Express Preemption by Section 903(1) of the Federal Bankruptcy Code

"Express preemption occurs when congressional intent to preempt state law is made explicit in the language of a federal statute." *Tobin*, 2014 WL 7388805, at *4. Here, Chapter 9 of the federal Bankruptcy Code contains an express preemption clause in section 903(1). Section 903, in its entirely, provides as follows:

> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State

> in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but-
>
> (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
>
> (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

11 U.S.C. § 903 (emphasis added). Thus, by enacting section 903(1), Congress expressly preempted state laws that prescribe a method of composition of municipal indebtedness that binds nonconsenting creditors.

The existence of this express preemption clause "does not immediately end the inquiry," however, because the Court must still ascertain "the substance and scope of Congress' displacement of state law." *See Altria Grp., Inc. v. Good*, 555 U.S. 70, 76 (2008). "Congressional intent is the principal resource to be used in defining the scope and extent of an express preemption clause," and courts look to the clause's "text and context" as well as its "purpose and history" in this endeavor. *Brown v. United Airlines, Inc.*, 720 F.3d 60, 63 (1st Cir. 2013).

Accordingly, to determine whether section 903(1) preempts the Recovery Act, the Court first examines the clause's text and then considers its history, purpose, and context.

1. Section 903(1) Textual Analysis

(a) "A State law"

By its terms, section 903(1) applies to "State" laws. 11 U.S.C. § 903(1). Thus, an initial inquiry is whether Congress intended for section 903(1) to apply to Puerto Rico laws. The federal Bankruptcy Code provides in section 101(52) that "[t]he term 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title." *Id.* § 101(52). Therefore, Puerto Rico is a "State" within the meaning of section 903(1) unless section 903(1) fits into the narrow exception of "defining who may be a debtor under chapter 9." *See id.* Section 903(1) prohibits state composition laws that bind nonconsenting creditors; it says nothing of who may be a Chapter 9 debtor. *Id.* § 903 (1).[12] Thus, it is

---

[12] Section 109 of the federal Bankruptcy Code, titled "Who may be a debtor," contains a subsection defining who may be a Chapter 9 debtor. 11 U.S.C. § 109(c) ("An entity may be a debtor under chapter 9 of this title if and only if such entity—(1) is a municipality; (2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter; (3) is insolvent; (4) desires to effect a plan to adjust such debts; and (5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (C) is unable to negotiate with creditors because such negotiation is impracticable; or (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.").

clear from the text that Puerto Rico is a "State" within the meaning of section 903(1).

To refute this very plain conclusion, the Commonwealth defendants argue that "the [Bankruptcy] Code specifically excludes Puerto Rico (as well as the District of Columbia) from the definition of 'State' for purposes of Chapter 9." *See* Civil No. 14-1518, Docket No. 95-1 at p. 16. If Congress intended to exclude Puerto Rico from the definition of "State" for purposes of all Chapter 9 provisions, then section 101(52) would likely read as follows: "The term 'State' includes the District of Columbia and Puerto Rico, except under chapter 9 of this title." But Congress included ten more words in section 101(52) that the Commonwealth defendants attempt to, but cannot, ignore: "The term 'State' includes the District of Columbia and Puerto Rico, except *for the purpose of defining who may be a debtor* under chapter 9 of this title." *See* 11 U.S.C. § 101(52) (emphasis added). In other words, Congress expressly defined "State" as including Puerto Rico and then enumerated a single, specific exception where the term "State" does not include Puerto Rico. To infer that Congress intended an additional or broader exception—*i.e.*, that Congress intended to exclude Puerto Rico from the definition of "State" for purposes of section 903(1) or for all of Chapter 9—would violate the canon of *expressio unius est exclusio alterius*. *See TRW Inc. v. Andrews*, 534 U.S. 19, 28 (2001) (explaining that where Congress explicitly enumerates a single exception, additional exceptions are not to be implied absent evidence of contrary legislative intent). The Commonwealth defendants' textual argument on this point thus holds no water.

(b) "Prescribing a method of composition of indebtedness"

Section 903(1) applies to state laws that "prescrib[e] a method of composition of indebtedness." 11 U.S.C. § 903(1). A "composition" is an "agreement between a debtor and two or more creditors for the adjustment or discharge of an obligation for some lesser amount." Black's Law Dictionary 346 (10th ed. 2014).

Chapter 2 of the Recovery Act permits an eligible public corporation to "seek debt relief from its creditors." Recovery Act § 201(b), through "any combination of amendments, modifications, waivers, or exchanges," which may include "interest rate adjustments, maturity extensions, debt relief, or other revisions to affected debt instruments," *id.* Stmt. of Motives, § E; *see id.* § 202(a). Chapter 3 of the Recovery Act permits an eligible public corporation "to defer debt repayment and to decrease interest and principal" owed to creditors. *Id.* Stmt. of Motives, § E; *see id.* §§ 301, 307-308, 310, 315.

Thus, both Chapters 2 and 3 of the Recovery Act create procedures for indebted public corporations to adjust or discharge their obligations to creditors. Therefore, the Recovery Act prescribes a method of composition of indebtedness, which is exactly what section 903(1) prohibits.

(c) "Of such municipality"

Section 903(1) applies to state laws addressing the indebtedness of a state "municipality." 11 U.S.C. § 903(1). A "municipality" is a "political subdivision or public agency or instrumentality of a State." *Id.* § 101(40).

The Recovery Act applies to debts of "any public sector obligor." Recovery Act § 104. A "public sector obligor" is defined as a "Commonwealth Entity," subject to three exclusions. *Id.* § 102(50).[13] A "Commonwealth Entity" includes "a department, agency, district, municipality, or instrumentality (including a public corporation) of the Commonwealth." *Id.* § 102(13).

Thus, the Recovery Act applies to the debts of Commonwealth "instrumentalities," which are "municipalities" for purposes of section 903(1).

(d) "May not bind any creditor that does not consent to such composition"

Finally, section 903(1) applies to state laws that bind nonconsenting creditors. 11 U.S.C. § 903(1).

Pursuant to Chapter 2 of the Recovery Act, if creditors representing at least fifty percent of the debt in a given class vote on whether to accept the proposed debt amendments, and at least seventy-five percent of participating voters approve, then the court order

---

[13] A "public sector obligor" is a "Commonwealth Entity, but excluding: (a) the Commonwealth; (b) the seventy-eight (78) municipalities of the Commonwealth; and (c) the Children's Trust; the Employees Retirement System of the Government of the Commonwealth of Puerto Rico and its Instrumentalities; GDB and its subsidiaries, affiliates, and entities ascribed to GDB; the Judiciary Retirement System; the Municipal Finance Agency; the Municipal Finance Corporation; the Puerto Rico Public Finance Corporation; the Puerto Rico Industrial Development Company, the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority; the Puerto Rico Infrastructure Financing Authority; the Puerto Rico Sales Tax Financing Corporation (COFINA); the Puerto Rico System of Annuities and Pensions for Teachers; and the University of Puerto Rico." Recovery Act § 102(50).

approving the debt relief transaction binds the entire class. Recovery Act §§ 115(b), 202(d), 204. Pursuant to Chapter 3 of the Recovery Act, if "at least one class of affected debt has voted to accept the plan by a majority of all votes cast in such class and two-thirds of the aggregate amount of affected debt in such class that is voted, " then the court order confirming the debt enforcement plan binds all of the public corporation's creditors, regardless of their class. *Id.* §§ 115(c), 315(e).

Thus, because they do not require unanimous creditor consent, the compositions prescribed in Chapter 2 and 3 of the Recovery Act may bind nonconsenting creditors.

2. Section 903(1) History, Purpose, and Context

The legislative history of section 903(1) and of its predecessor, section 83(i) of the Bankruptcy Act of 1937 ("section 83(i)"), further supports the conclusion that Congress intended to preempt Puerto Rico laws that create municipal debt restructuring procedures that bind nonconsenting creditors. In 1946, Congress added the following language, which is nearly identical to the language in section 903(1), to section 83(i): "[N]o State law prescribing a method of composition of indebtedness of such agencies shall be binding upon any creditor who does not consent to such composition." Pub. L. No. 481, § 83(i), 60 Stat. 409, 415 (1946). Congress explained why it added this prohibitory language to section 83(i) in a House Report:

> [A] bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the 48 States,

> as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent.

H.R. Rep. No. 79-2246, at 4 (1946).[14] Congress reaffirmed this intent when it enacted section 903(1) three decades later:

> The proviso in section 83, prohibiting State composition procedures for municipalities, is retained. Deletion of the provision would "permit all States to enact their own versions of Chapter IX", ... which would frustrate the constitutional mandate of uniform bankruptcy laws.

S. Rep. No. 95-989, at 110 (1978) .

It is evident from this legislative history that, because municipal bonds are widely held across the United States, Congress enacted section 903(1) to ensure that only a uniform federal law could force nonconsenting municipal bondholders to surrender or cancel part of their investments. Nothing in its legislative history indicates that Congress intended to exempt Puerto Rico from section 903(1)'s expressly universal preemption purview.

---

[14] *See also Hearings on H.R. 4307 Before the Special Subcomm. on Bankr. & Reorg. of the H. Comm. on the Judiciary*, 79th Cong. 10 (1946) (statement of Millard Parkhurst, Att'y at Law, Dallas, Tex.) ("Bonds of a municipality are usually distributed throughout the 48 States. Certainly any law which would have the effect of requiring the holders of such bonds to surrender or cancel a part of their investments should be uniform Federal law and not a local law.").

The Commonwealth defendants nonetheless argue that section 903(1) does not apply to Puerto Rico laws. They do not attempt to rebut the provision's clear legislative history, however, and instead present arguments based on logic and context. First, the Commonwealth defendants contend that it would be "anomalous" to read the federal Bankruptcy Code as both precluding Puerto Rico municipalities[15] from participating in Chapter 9 proceedings *and* preempting Puerto Rico laws that govern debt restructuring for Puerto Rico municipalities. (Civil No. 14-1518, Docket No. 95-1 at p. 17.) But Puerto Rico municipalities are not unique in their inability to restructure their debts. This is because Chapter 9 is available to a municipality only if it receives specific authorization from its state, 11 U.S.C. § 109(c)(2), and many states have not enacted authorizing legislation.[16] Congress's decision not to permit Puerto Rico municipalities to be Chapter 9 debtors, *see* 11 U.S.C. 101(52),[17] reflects its

---

[15] "Municipality," as used in this discussion, includes a "public agency or instrumentality." *See* 11 U.S.C. § 101(40).

[16] *See* James E. Spiotto, et al., Chapman & Cutler LLP, *Municipalities in Distress? How States and Investors Deal with Local Government Financial Emergencies* 51-52 (2012) (identifying twelve states with statutes that specifically authorize municipalities to file a Chapter 9 petition, twelve states that conditionally authorize it, three states that grant limited authorization, two states that prohibit filing (although one has an exception to the prohibition), and twenty-one states that are either unclear or have not enacted specific authorization).

[17] Congress enacted section 101(52) as part of the 1984 amendments to the federal Bankruptcy Code. Prior to those amendments, the Bankruptcy Code contained no definition of the term "State." *Compare* Pub. L. No. 95-598, 92 Stat. 2549, 2549-54 (Nov. 6, 1978) (no definition of "State"), *with* Pub. L. No. 98-353, 98 Stat. 333, 368-69 (July 10, 1984) (adding definition of "State").

considered judgment to retain control over any restructuring of municipal debt in Puerto Rico. Congress, of course, has the power to treat Puerto Rico differently than it treats the fifty states. *See* 48 U.S.C. § 734 (providing that federal laws "shall have the same force and effect in Puerto Rico as in the United States" "except as ... otherwise provided"); *Antilles Cement Corp.*, 670 F.3d at 323 ("Congress is permitted to treat Puerto Rico differently despite its state-like status.").

Next, the Commonwealth defendants contend that section 903 does not apply to Puerto Rico because that section "addresses the impact of '[t]his chapter'—*i.e.*, Chapter 9—on States' authority to regulate the debt restructuring of their own [municipalities]." (Civil No. 14-1518, Docket No. 95-1 at pp. 19-20.) They reason that because Puerto Rico municipalities are not eligible to participate in Chapter 9 bankruptcy proceedings, "it follows that [s]ection 903 does not apply." *Id.* The Commonwealth defendants misread section 903, which first clarifies that Chapter 9 "does not limit or impair the power of a State to control" the political or governmental powers of its municipalities, 11 U.S.C. § 903, and then qualifies that statement by prohibiting state laws that bind nonconsenting creditors to a composition of indebtedness of a municipality, and prohibiting judgments entered pursuant to those laws that bind nonconsenting creditors, *id.* § 903(1)-(2). Nothing in the text, context, or legislative history of section 903 remotely supports the Commonwealth defendants' inferential leap that Congress intended the prohibition in section 903(1) to apply only to states

whose municipalities are eligible to file for Chapter 9 bankruptcy.[18]

Finally, the Commonwealth defendants argue that section 903 "by its terms is limited to the relationship between an 'indebted[]' municipality and its 'creditors' in Chapter 9 cases," and that "[u]nless a municipality can qualify as a 'debtor' under Chapter 9, it obviously cannot be an 'indebted[]' municipality with a 'creditor' under Chapter 9." (Civil No. 14-1518, Docket No. 95-1 at p. 20.) The Commonwealth defendants rely on the Bankruptcy Code's definition of "creditor" to support their strained reading, but nothing in that definition indicates that the term "creditor" is limited to entities eligible to bring claims pursuant to Chapter 9. *See* 11

---

[18] The Commonwealth defendants cite to an journal article by Thomas Moers Mayer for support. (Civil No. 14-1518, Docket No. 108 at p. 10.) The article states as follows in a tangential footnote: "Section 903(1) ... appears as an exception to [section] 903's respect for state law in [C]hapter 9 and thus appears to apply only in a [C]hapter 9 bankruptcy. It is not clear how it would apply if no [C]hapter 9 case was commenced." Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, and a Reconsideration of Chapter 9*, 85 Am. Bankr. L.J. 363, 386 n.84 (2011). But reading section 903(1) as applying only when a Chapter 9 bankruptcy has commenced would deprive section 903(1) of any practical effect: a municipal debtor that has already invoked federal bankruptcy law has no need to employ state bankruptcy laws. More significantly, this reading is contrary to the legislative history of section 903(1) and its predecessor, which unequivocally indicates that Congress's intent in enacting the provision was to ensure that a "bankruptcy law under which bondholders of a municipality are required to surrender or cancel their obligations [is] uniform throughout the [United] States" because "[o]nly under a Federal law should a creditor be forced to accept such an adjustment without his consent." H.R. Rep. No. 79-2246, at 4 (1946). The Commonwealth defendants' reliance on Mr. Mayer's conjectural observation is therefore unavailing.

U.S.C. § 101(10) (defining "creditor" as (1) an "entity that has a claim against the debtor," (2) an "entity that has a claim against the estate," or (3) "an entity that has a community claim"); *id.* § 101(5) (defining "claim" as a "right to payment"). Thus, the Commonwealth defendants' attempt to read a "Chapter 9 eligibility" requisite into the scope of section 903(1) is wholly without textual support, and the legislative history of that section supports a contrary, universal reading of the prohibition.[19]

3. Express Preemption Conclusion

The Court recognizes that federal preemption of a state law "is strong medicine" and "will not lie absent evidence of clear and manifest congressional purpose." *Mass. Ass'n of Health Maint. Orgs. v. Ruthardt*, 194 F.3d 176, 178-79 (1st Cir. 1999). Despite this high bar, this is not a close case. Section 903(1)'s text and legislative history provide direct evidence of Congress's clear and manifest purpose to preempt state laws that

---

[19] The Commonwealth defendants rely on another academic article for support. (Civil No. 14-1518, Docket No. 108 at p. 10.) The article, by Stephen J. Lubben, looks to the statutory definitions of "creditor" as an "entity that has a claim against the debtor," 11 U.S.C. § 101(10)(A), and of "debtor" as a "person or municipality concerning which a case under this title has been commenced," *id.* § 101(13), to conclude that "section 903 was only intended to apply to debtors who might actually file under [C]hapter 9." Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 Am. Bankr. L.J. 553, 576 (2014). This narrow construction of section 903(1) flies in the face of section 903(1)'s legislative history, which Mr. Lubben and the Commonwealth defendants totally ignore. The Senate Report accompanying section 903(1)'s enactment indicates that Congress sought to avoid states "enact[ing] their own versions of Chapter [9], ... which would frustrate the constitutional mandate of uniform bankruptcy laws." S. Rep. No. 95-989, at 110 (1978).

prescribe a method of composition of municipal indebtedness that binds nonconsenting creditors, *see* 11 U.S.C. § 903(1), and to include Puerto Rico laws in this preempted arena, *see id.* § 101(52). The Recovery Act is such a law and is therefore unconstitutional pursuant to the Supremacy Clause of the United States Constitution.

D. Conflict and Field Preemption

Unlike their Franklin and Oppenheimer Rochester counterparts, who plead that section 903(1) is an express preemption clause, plaintiff BlueMountain raises many of the same section 903(1) arguments but frames them as "conflict preemption" and "field preemption." (Civil No. 14-1569, Docket No. 20 at pp. 13-18.)

Conflict preemption occurs "when federal law is in 'irreconcilable conflict' with state law." *Telecomm. Regulatory Bd. of P.R. v. CTIA-Wireless Ass'n*, 752 F.3d 60, 64 (1st Cir. 2014) (quoting *Barnett Bank of Marion Cnty., N.A. v. Nelson*, 517 U.S. 25, 31 (1996)). As explained above, section 903(1) of the federal Bankruptcy Code prohibits state laws that create composition procedures for indebted municipalities that bind nonconsenting creditors, and the Recovery Act is such a law.[20] Section 903(1) of the federal Bankruptcy Code and the Recovery Act are thus in "irreconcilable conflict."

Conflict preemption also occurs "when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Telecomm. Regulatory Bd. of P.R.*, 752 F.3d at 64 (internal quotation marks and citation omitted).

---

[20] *See supra* Part IV.C.

Again, as previously discussed, the text and legislative history of section 903(1) indicate that Congress intended to ensure that only pursuant to a uniform federal law would nonconsenting creditors be forced to accept municipal compositions.[21] The Recovery Act stands as an obstacle to achieving this purpose because it prescribes municipal composition procedures that are outside of the federal Bankruptcy Code and are available only to Puerto Rico "municipalities."

Field preemption occurs when states "regulat[e] conduct in a field that Congress, acting within its proper authority, has determined must be regulated by its exclusive governance." *Arizona*, 132 S. Ct. at 2501. Congressional intent to preempt state law in an entire field "can be inferred from a framework of regulation 'so pervasive ... that Congress left no room for the States to supplement it' or where there is a 'federal interest ... so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject.'" *Id.* (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). Here, however, the Court need not resort to these modes of inference because Congress enacted an express preemption clause that delineates the parameters of the field it intended to preempt. Thus, the Court goes no further than finding that, by enacting section 903(1), Congress expressly preempted the field of municipal composition procedures that bind nonconsenting creditors. *See* 11 U.S.C. § 903 (1).

E. "Dormant Bankruptcy Clause" Preemption

"Wholly apart" from their section 903(1) express preemption claim, the Franklin Oppenheimer and

---

[21] *See supra* Part III.C.

Rochester plaintiffs raise a somewhat novel argument that the Bankruptcy Clause of the United States Constitution, by itself, preempts the Recovery Act. (Civil No. 14-1518, Docket No. 79 at pp. 21-23.) The plaintiffs contend that the United States Supreme Court has long held that the Bankruptcy Clause grants the power to authorize a discharge to the federal government alone, and that states therefore are prohibited from enacting bankruptcy discharge laws. *Id.* at p. 21. The Supreme Court cases that plaintiffs cite, however, indicate that the constitutional prohibition on state bankruptcy discharge laws arises not from the Bankruptcy Clause, but from the Contract Clause. *See Sturges v. Crowninshield*, 17 U.S. 122, 199 (1819) ("The constitution does not grant to the states the power of passing bankrupt laws, ... [but restrains states' power] as to *prohibit the passage of any law impairing the obligation of contracts.* Although, then, the states may, until that power shall be exercised by congress, pass laws concerning bankrupts; yet they cannot constitutionally introduce into such laws a clause which discharges the obligations the bankrupt has entered into." (emphasis added)); *Ry. Labor Execs.' Ass'n v. Gibbons*, 455 U.S. 457, 472 n.14 (1982) ("Apart from and independently of the Supremacy Clause, the Contract Clause prohibits the States from enacting debtor relief laws which discharge the debtor from his obligations."). The Court therefore rejects the Franklin Oppenheimer and Rochester plaintiffs' "dormant Bankruptcy Clause" preemption argument and will address the Contract Clause issues in Part V of this opinion.

F. Preemption Conclusion

Section 903(1) of the federal Bankruptcy Code preempts the Recovery Act. The Recovery Act is therefore unconstitutional pursuant to the Supremacy Clause of the United States Constitution. Accordingly, the Court **DENIES** the Commonwealth defendants' motions to dismiss plaintiffs' preemption claims, (Civil No. 14-1518, Docket No. 95; Civil No. 14-1569, Docket No. 29), and **GRANTS** the Franklin and Oppenheimer Rochester plaintiffs' cross-motion for summary judgment on their preemption claim, (Civil No. 14-1518, Docket No. 78).

V. CONTRACT CLAUSES

Plaintiffs seek a declaratory judgment that the Recovery Act violates the Contract Clause of the United States Constitution by impairing the contractual obligations imposed by the Authority Act and the Trust Agreement. (Civil No. 14-1518, Docket No. 85 at ¶ 66; Civil No. 14-1569, Docket No. 20 at ¶ 83(b).) Plaintiff BlueMountain seeks an additional declaratory judgment that the Recovery Act violates the Contract Clause of the Puerto Rico Constitution for the same reason. (Civil No. 14-1569, Docket No. 20 at ¶ 83(c).) The Commonwealth defendants move to dismiss.[22] (Civil No. 14-1518, Docket No. 95; Civil No. 14-1569, Docket No. 29.)

---

[22] In their motions to dismiss, the Commonwealth defendants contend that the plaintiffs "are mounting a facial challenge" to the Recovery Act and that therefore the plaintiffs "must show that the [Recovery Act] cannot constitutionally be applied not only to their contracts, but to any contracts [sic]." (Civil No. 14-1518, Docket No. 95-1 at p. 23.) Plaintiffs, however, specifically challenge the Recovery Act as it applies to the contractual relationships between plaintiffs, PREPA, and the Commonwealth created in the

The Commonwealth defendants' motions to dismiss are again governed by Rule 12(b)(6), and the Court will dismiss the complaints if they fail to state a plausible legal claim upon which relief can be granted. *See* Fed. R. Civ. P. 12(b)(6); *Ocasio-Hernandez*, 640 F.3d at 12-13. The Court "must assume the truth of all well-pleaded facts and give the plaintiff [s] the benefit of all reasonable inferences therefrom." *United Auto., Aerospace, Agric. Implement Workers of Am. Int'l Union v. Fortuño*, 633 F.3d 37, 39 (1st Cir. 2011) [hereinafter *UAW*] (quoting *Thomas v. Rhode Island*, 542 F.3d 944, 948 (1st Cir. 2008)). The Court considers "only facts and documents that are part of or incorporated into the complaint[s]." *Id.* (quoting *Trans-Spec Truck Serv., Inc. v. Caterpillar Inc.*, 524 F.3d 315, 321 (1st Cir. 2008)). The Court accordingly examines both the factual allegations in plaintiffs' complaints and the Trust Agreement, which plaintiffs incorporated by reference into their complaints. *See*

Authority Act and the Trust Agreement. *See* Civil No. 14-1518, Docket No. 85 at ¶ 71 (ii) (seeking declaration that the Recovery Act violates the Contract Clause "insofar as it permits the retroactive impairment of Plaintiffs' rights under the contracts governing the PREPA bonds"); Civil No. 14-1518, Docket No. 20 at ¶ 83(b) (same). Accordingly, the Court interprets plaintiffs' contract clause claims as "as-applied" challenges. *Cf. John Doe No. 1 v. Reed*, 561 U.S. 186, 194 (2010) (noting that when "the relief that would follow" from a claim "reach[es] beyond the particular circumstances of the[] plaintiffs," plaintiffs must satisfy the standards for a facial challenge); *Asociacion de Suscripcion Conjunta del Seguro de Responsabilidad Obligatorio v. Juarbe-Jimenez*, 659 F.3d 42, 48 (1st Cir. 2011) (where plaintiffs request a declaration that a regulation is unconstitutional, rather than a declaration that a particular interpretation or application of the regulation is unconstitutional, plaintiffs mount a facial challenge).

Civil No. 14-1518, Docket No. 85 at ¶ 3; Civil No. 14-1569, Docket No. 20 at ¶ 14.

The Contract Clause of the Puerto Rico Constitution, P.R. Const, art. II, § 7, is analogous to the Contract Clause of the United States Constitution, U.S. Const, art. I, § 10, cl. 1, and provides at least the same level of protection against the impairment of the obligation of contracts. *Bayron Toro v. Serra*, 119 P.R. Offic. Trans. 646, 661-62 (P.R. 1987). The parties do not dispute this. *See* Civil No. 14-1569, Docket Nos. 20 at ¶ 74 & 29-1 at p. 22 n.l. Plaintiff BlueMountain's invocation of the Puerto Rico Contract Clause therefore adds nothing to the Court's analysis.

A. Contract Clause Principles

The Contract Clause of the United States Constitution provides that "No State shall ... pass any ... Law impairing the Obligation of Contracts...." U.S. Const, art. I, § 10, cl. 1.[23] "Despite its unequivocal language, this constitutional provision does not make unlawful every state law that conflicts with any contract." *UAW*, 633 F.3d at 41 (internal quotation marks and citation omitted). Rather, courts must "reconcile the strictures of the Contract Clause" with the state's sovereign power to safeguard the welfare of its citizens. *Id.* (internal quotation marks and citation omitted).

Accordingly, Contract Clause claims are analyzed pursuant to a two-pronged test. *Id.* The first question is whether the state law "operate [s] as a substantial impairment of a contractual relationship." *Id.*

---

[23] The Commonwealth defendants do not contest that the Contract Claus applies to Puerto Rico, even though it is not a state. (Civil No. 14-1518, Docket No. 95-1 at p. 22 n.1.)

(quoting *Energy Reserves Grp., Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411 (1983)). If the contractual relationship is substantially impaired, then the second question is whether that impairment is "reasonable and necessary to serve an important public purpose." *Id.* (quoting *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 25 (1977)).

B. Substantial Impairment of a Contractual Relationship

The question of whether a state law operates as a substantial impairment of a contractual relationship includes three components: "whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial." *Gen. Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992).

1. Contractual Relationship

Plaintiffs claim that the Recovery Act impairs the contractual relationships created by the Trust Agreement and the Authority Act. The Commonwealth defendants do not contest the plaintiffs' allegations that the Trust Agreement creates a contractual relationship between PREPA and PREPA bondholders, and that bondholders relied on PREPA's promises in the Trust Agreement when they acquired PREPA bonds. *See* Civil No. 14-1518, Docket No. 85 at ¶ 42; Civil No. 14-1569, Docket No. 20 at ¶¶ 14-17.

The Commonwealth defendants also do not deny that the Authority Act creates a contractual relationship between the Commonwealth and PREPA bondholders. The Authority Act's statutory language makes clear the intent to form a contract. *See* P.R. Laws Ann. tit. 22 § 215 ("The Commonwealth

Government does hereby pledge to, and agree with, any person, firm or corporation ... subscribing to or acquiring bonds of [PREPA]...."); *cf. U.S. Trust Co.*, 431 U.S. at 18 (finding that New York and New Jersey's intent to make a contract with bondholders is clear from the following statutory language: "The 2 States covenant and agree with each other and with the holders of any affected bonds ..."). Even absent this statutory language, the Trust Agreement is assumed to incorporate the terms of the Authority Act because the Authority Act was in place when PREPA and the bondholders agreed to the Trust Agreement. *See U.S. Trust Co.*, 431 U.S. at 19 ("The obligations of a contract long have been regarded as including not only the express terms but also the contemporaneous state law pertaining to interpretation and enforcement.... This principle presumes that contracting parties adopt the terms of their bargain in reliance on the law in effect at the time the agreement is reached."); *Ionics, Inc. v. Elmwood Sensors, Inc.*, 110 F.3d 184, 188 (1st Cir. 1997) ("Every contract is assumed to incorporate the existing legal norms that are in place.").

2. Impairment

Plaintiffs allege that the Recovery Act impairs the contractual relationships and obligations created in the Authority Act and the Trust Agreement in the following specific ways:[24]

(a) In the Authority Act, the Commonwealth guaranteed PREPA bondholders that it would not "limit or alter the rights or powers ... vested in [PREPA] until all

---

[24] *See* Civil No. 14-1518, Docket No. 85 at ¶¶ 42-48; Civil No. 14-1569, Docket No. 20 at ¶ 56.

such bonds at any time issued, together with any interest thereon, are fully met and discharged." P.R. Laws Ann. tit. 22 § 215. PREPA similarly guaranteed in the Trust Agreement that "no contract or contracts will be entered into or any action taken by which the rights of the Trustee or of the bondholders might be impaired or diminished." Trust Agreement § 709. PREPA also promised to pay principal and interest on the bonds when they are due. *Id.* § 701. Finally, the Trust Agreement prohibits both the extension of the maturity date of principal or interest due on the PREPA bonds and the reduction of the principal or interest rate of PREPA bonds. *Id.* § 1102. The Recovery Act impairs all of these obligations and guarantees by permitting PREPA to modify its debts without creditor consent. Recovery Act §§ 115, 202, 206, 304, 312, 315, 322.

(b) In the Trust Agreement, PREPA promised that it would not create liens on PREPA revenues that would take priority over the bondholders' lien. Trust Agreement §§ 712, 1102. The Recovery Act impairs this promise by allowing PREPA to encumber collateral with liens senior to the bondholders' lien. Recovery Act § 322.

(c) The Trust Agreement prohibits PREPA from selling any part of its electrical-power system. The Recovery Act impairs

this contractual prohibition by permitting the special court to authorize the sale of PRE PA assets free and clear of liens. Recovery Act § 307.

(d) The Trust Agreement contains an *ipso facto* clause providing that PREPA is deemed in default if (1) it institutes a proceeding effectuating a composition of debt with its creditors, or (2) an order or decree is entered effectuating a composition of debt between PREPA and its creditors or for the purpose of adjusting claims that are payable from PREPA revenues. Trust Agreement § 802(f)-(g). The Recovery Act renders this *ipso facto* clause unenforceable by providing that "[n]otwithstanding any contractual provision ... to the contrary, a contract of a petitioner may not be terminated or modified, and any right or obligation under such contract may not be terminated or modified ... solely because of a provision in such contract conditioned on" a default due to the corporation's insolvency or the filing of a petition under section 301 of the Recovery Act. Recovery Act § 325.

(e) The Trust Agreement provides that holders of at least 10 percent of PREPA bonds are entitled to request that the Trustee bring an action to compel PREPA to set and collect rates sufficient to maintain its promises both to pay current expenses and to maintain at least 120

percent of upcoming principal and interest payments in its general fund. Trust Agreement § 502. The Trust Agreement also entitles bondholders to accelerate payments if PREPA defaults, *id.* § 803, and to sue in equity or at law to enforce the remedies of the Trust Agreement if PREPA defaults, *id.* § 804. The Recovery Act impairs bondholders' rights to these remedies both during the suspension and stay provisions, Recovery Act §§ 205, 304, and after the special court approves a plan pursuant to Chapter 2 or 3, *id.* §§ 115(b)(2), 115(c)(3).

(f) Section 17 of the Authority Act grants bondholders the right to seek appointment of a receiver if PREPA defaults. P.R. Laws Ann. tit. 22 § 207. This right is incorporated into section 804 of the Trust Agreement, which guarantees that bondholders have the right to seek "the appointment of a receiver as authorized by the Authority Act" if PREPA defaults. Trust Agreement § 804. The Recovery Act expressly eliminates the right to seek the appointment of a receiver. Recovery Act § 108(b) ("This Act supersedes and annuls any insolvency or custodial provision included in the enabling or other act of any public corporation, including Section 17 of [the Authority Act].").

The United States Supreme Court has long held that the Contract Clause prohibits states from passing

laws, like the Recovery Act, that authorize the discharge of debtors from their obligations. *See Ry. Labor Execs.' Ass'n*, 455 U.S. at 472 n.14 ("[T]he Contract Clause prohibits the States from enacting debtor relief laws which discharge the debtor from his obligations."); *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918) ("It is settled that a state may not pass an insolvency law which provides for a discharge of the debtor from his obligations."); *Sturges*, 17 U.S. at 199 (Contract Clause prohibits states from introducing into bankruptcy laws "a clause which discharges the obligations the bankrupt has entered into.").

The Commonwealth Legislative Assembly cites *Faitoute Iron & Steel Co. v. City of Asbury Park, New Jersey*, 316 U.S. 502 (1942), as support for the Recovery Act's "constitutional basis." Recovery Act, Stmt. of Motives, § C. In *Faitoute*, the Supreme Court sustained a state insolvency law for municipalities in the face of a Contract Clause challenge. 316 U.S. at 516. The state law was narrowly tailored in three important ways: (1) it explicitly barred any reduction of the principal amount of any outstanding obligation; (2) it affected only *unsecured* municipal bonds that had no real remedy; and (3) it provided only for an extension to the maturity date and a decrease of the interest rates on the bonds. *Id.* at 504-07. The Supreme Court was careful to state: "We do not go beyond the case before us. Different considerations may come into play in different situations. Thus we are not here concerned with legislative changes touching secured claims." *Id.* at 516. Unlike the state law in *Faitoute*, the Recovery Act (1) permits the reduction of principal owed on PREPA bonds, (2) affects *secured* bonds that have meaningful remedies, including the appointment of a receiver, and

(3) permits modifications to debt obligations beyond the extension of maturity dates and adjustment of interest rates. Thus, *Faitoute* is factually distinguishable and provides no support for the Recovery Act's constitutionality.

The Commonwealth defendants raise only one argument as to why the Recovery Act does not impair a contractual relationship. They insist that there is "no way to know whether a contract will be impaired ... unless and until the [Recovery Act] is invoked and the debts covered by the contract are restructured in a way that gives creditors less value than they could reasonably expect to receive without the [Recovery Act]." (Civil No. 14-1518, Docket No. 95-1 at p. 23.) This argument is unpersuasive. When a state law authorizes a party to do something that a contract prohibits it from doing, or when a state law prohibits a party from doing something that a contract authorizes it to do, the state law "impairs" a contractual relationship, independent of whether or how the party acts pursuant to the state law. *See, e.g., U.S. Trust Co.*, 431 U.S. at 19-21 (where statutory covenant prohibited Port Authority from spending revenues securing bonds, state law that repealed the covenant—authorizing Port Authority to spend revenue securing bonds—impaired the contractual relationship between the state and bondholders, regardless of whether Port Authority spent the revenues).

3. Substantial Impairment

To determine whether a state law's impairment of a contractual relationship is sufficiently "substantial" to trigger the Contract Clause, courts look to whether the impaired rights were the seller's "central undertaking" in the contract and whether the rights "substantially

induced" the buyer to enter into the contract. *City of El Paso v. Simmons*, 379 U.S. 497, 514 (1965). Courts also look to how the contract right was impaired—whether it was "totally eliminated" or "merely modified or replaced by an arguably comparable" provision. *U.S. Trust Co.*, 431 U.S. at 19, *accord Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124, 128-29 (1937) ("The Legislature may modify, limit, or alter the remedy for enforcement of a contract without impairing its obligation, but in so doing, it may not deny all remedy or so circumscribe the existing remedy with conditions and restrictions as seriously to impair the value of the right. The particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away.")

Here, PREPA's obligation to pay principal and interest on the bonds when due was its central undertaking in the Trust Agreement. *See* Trust Agreement § 701. This promise also substantially induced the bondholders to purchase the bonds from PREPA: if there were no promise that they would receive a return on their investment, they likely would not have invested. The Recovery Act does not make a single or modest impairment to PREPA's obligation. For example, it does not permit PREPA merely to extend the maturity dates or to lower interest rates on its bonds. *Cf. Faitoute*, 316 U.S. at 507 (state law providing for an extension of the maturity dates and a decrease in the interest rates found not to violate Contract Clause). Rather, the Recovery Act permits PREPA to modify its debts in a variety of ways, including discharge of principal and interest owed, without creditor consent.

The promise of numerous remedies—including (1) the right to a senior lien on revenues, (2) the prohibition on PREPA selling its electrical-power system, (3) an *ipso facto* clause triggering default remedies, (4) the right to bring an action to compel PREPA to set and collect rates, (5) the right to accelerate payments, (6) the right to sue to enforce the remedies, and (7) the right to seek the appointment of a receiver—likely substantially induced the bondholders to purchase bonds from PREPA because these are valuable security provisions that encourage investment. *See W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56, 62 (1935) (finding state law modifications to several bondholder remedies, when "viewed in combination" are "an oppressive and unnecessary destruction of nearly all the incidents that give attractiveness and value to collateral security"). *U.S. Trust Co.*, 431 U.S. at 19 (finding state repeal of covenant that assured bondholders that the revenues and reserves securing their bonds would not be used for purposes other than those specifically delineated in the covenant impaired the obligation of the state's contract because it "totally eliminated an important security provision"). The Recovery Act does not merely modify these remedies or replace them with comparable security provisions, it completely extinguishes all of them.

The Commonwealth defendants argue for the first time in their replies to the plaintiffs' oppositions to the motions to dismiss that any impairment of plaintiffs' contractual rights is not substantial because the impaired rights were not central to the parties' undertaking. (Civil No. 14-1518, Docket No. 108 at p. 16.) The Commonwealth defendants rely on *City of Charleston v. Public Service Commission of West*

Virginia, 57 F.3d 385 (4th Cir. 1995), for this contention, but even that case supports the opposite conclusion. In *City of Charleston*, the Fourth Circuit Court of Appeals concluded that the modification of the bond contracts such that "one remedy—the right to impose liens—was removed as to one relatively small group" was not substantial. 57 F.3d at 394. Here, plaintiffs enumerate not one, but at least seven remedies that the Recovery Act eliminated. Even more, the Recovery Act nullified PREPA's promise to pay full principal and interest and the Commonwealth's promise to not alter the rights vested in PREPA until the bonds and interest are fully paid and discharged.

Thus, because the Recovery Act totally extinguishes significant and numerous obligations, rights, and remedies, the Court easily concludes that the impairment caused by the Recovery Act is substantial.

C. Reasonable and Necessary to Serve an Important Government Purpose

The second prong of the Contract Clause test is whether the impairment is "reasonable and necessary to serve an important government purpose." *UAW*, 633 F.3d at 41 (quoting *U.S. Trust Co.*, 431 U.S. at 25). "[T]he reasonableness inquiry asks whether the law is reasonable in light of the surrounding circumstances, and the necessity inquiry focuses on whether [the state] imposed a drastic impairment when an evident and more moderate course would serve its purposes equally well." *Id.* at 45-46 (internal quotation marks and citations omitted). The First Circuit Court of Appeals places the burden of establishing a lack of reasonableness and necessity on the plaintiff and

explains as follows regarding how the plaintiff can carry that burden:

> [A] plaintiff with reason to believe that a state action was unreasonable or unnecessary can, in the complaint, list the state's articulated motive(s), and then plead facts that undermine the credibility of the those stated motives or plead facts that question the reasonableness or necessity of the action in advancing the stated goals. For example, if a state purports to impair a contract to address a budgetary crisis, a plaintiff could allege facts showing that the impairment did not save the state much money, the budget issues were not as severe as alleged by the state, or that other cost-cutting or revenue-increasing measures were reasonable alternatives to the contractual impairment at issue.

Id. at 45.

Here, the Commonwealth Legislative Assembly indicates in the Recovery Act's Statement of Motives that the Recovery Act addresses the "current state of fiscal emergency" in Puerto Rico. Recovery Act, Stmt. of Motives, § A. It avers that the downgrade to non-investment grade of Puerto Rico's general obligation bonds "places the economic and fiscal health of the people of Puerto Rico at risk, and improperly compromises the credit of the Central Government and its public corporations." *Id.* The Commonwealth Legislative Assembly further explains that Puerto Rico's three main public corporations have a combined

debt adding up to $20 billion, and if "public corporations were to default on their obligations in a manner that permits creditors to exercise their remedies in a piecemeal way, the lack of an effective and orderly process to manage the interests of creditors and consumers[] would threaten the ability of the Commonwealth's government to safeguard the interests of the public to continue receiving essential public services and promote the general welfare of the people of Puerto Rico." *Id.*

Because the Commonwealth is alleged to have impaired a public contract, "where the impairment operates for the state's benefit," the Court gives limited deference to the Commonwealth's determination of reasonableness and necessity. *See Parella v. Ret. Bd. of R.I. Employees' Ret. Sys.*, 173 F.3d 46, 59 (1st Cir. 1999) (internal quotation marks and citations omitted); *accord McGrath v. R.I. Ret. Bd.*, 88 F.3d 12, 16 (1st Cir. 1996) ("[A] state must do more than mouth the vocabulary of the public weal in order to reach safe harbor; ... [an] objective ... that reasonably may be attained without substantially impairing the contract rights of private parties[] will not serve to avoid the full impact of the Contracts Clause.").

The plaintiffs plead the following facts, which the Court accepts as true at this stage in the litigation, to demonstrate that other cost-cutting and revenue-increasing measures are reasonable alternatives to the Recovery Act's drastic impairment of contract rights:[25]

---

[25] *See* Civil No. 14-1518, Docket No. 85 at ¶¶ 50-54; Civil No. 14-1569, Docket No. 20 at ¶¶ 57-64.

1. PREPA could modestly raise its rates. It has not increased its basic charges since 1989.

2. PREPA could collect the $640.83 million currently owed to it by the Commonwealth.

3. PREPA could reduce the amount of funds currently diverted to municipalities and subsidies. PREPA is exempt from taxation but is required to set aside 11 percent of its gross revenues each year to pay "contributions in lieu of taxes" to municipalities and other subsidies. These contributions are expected to total almost $1 billion from 2014 to 2018.

4. PREPA could cut costs and correct inefficiencies in its management. PREPA has been reported to have (1) a highly overstaffed human resources and labor department compared to peer corporations, (2) high costs for customer service, (3) under-competitive bidding procedures for its equipment, (4) surplus equipment and other inventory above that needed for storm preparedness, (5) high overtime charges from employees and lenient timekeeping standards, and (6) weak accounting controls.

5. PREPA could improve its standing in the global capital markets and take other measures to improve relationships with creditors. PREPA has not been reported to have hired a capital markets investment banker since its 2013A bonds

were issued, it has not presented publicly to investors since May 2013, and it has not publicly disclosed any intention to apply for a federal guarantee under the "Advanced Fossil Energy Projects" solicitation issued by the United States Department of Energy in December 2013.

6. PREPA could negotiate with creditors to restructure its debts on a voluntary basis. The Recovery Act was passed before any meaningful attempt to engage in such negotiations.

The Court has no reason to doubt that the Commonwealth enacted the Recovery Act to address Puerto Rico's current state of fiscal emergency. But even when acting to serve an important government purpose, the Commonwealth can impair contractual relationships only through reasonable and necessary measures. The Court infers from plaintiffs well-pled and numerous factual allegations that the Recovery Act imposes a "drastic impairment" when several other "moderate course[s]" are available to address Puerto Rico's financial crisis. *See U.S. Trust Co.*, 431 U.S. at 31 ("[A] State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well.")

D. Contract Clauses Conclusion

For the foregoing reasons, the plaintiffs state a plausible claim pursuant to the contract clauses of the United States and Puerto Rico constitutions. The Court accordingly **DENIES** the Commonwealth defendants' motions to dismiss, (Civil No. 14-1518, Docket No. 95; Civil No. 14-1569, Docket No. 29), as to plaintiffs' contract clauses claims.

VI. TAKINGS CLAUSE

The Franklin and Oppenheimer Rochester plaintiffs seek a declaratory judgment that the Recovery Act violates the Takings Clause of the United States Constitution by taking without just compensation (1) plaintiffs' contractual right to seek the appointment of a receiver, and (2) plaintiffs' liens on PREPA revenues. (Civil No. 14-1518, Docket No. 85 at ¶¶ 32-39, 62-63.) The Commonwealth defendants move to dismiss on ripeness grounds pursuant to Rule 12(b)(1) and for failure to state a claim pursuant to Rule 12(b)(6). (Civil No. 14-1518, Docket No. 95.)

A. Plaintiffs State a Plausible Claim for Relief Based on the Taking of Their Contractual Right to Seek the Appointment of a Receiver

Plaintiffs first seek a declaratory judgment that section 108(b) of the Recovery Act effectuates a taking without just compensation of plaintiffs' right to seek the appointment of a receiver in vioiation of the Takings Clause. (Civil No. 14-1518, Docket No. 85 at ¶ 63.) Section 17 of the Authority Act grants bondholders the right to seek appointment of a receiver if PREPA defaults. P.R. Laws Ann. tit. 22 § 207. This right is incorporated into section 804 of the Trust Agreement, which guarantees that bondholders have the right to seek "the appointment of a receiver as authorized by the Authority Act" if PREPA defaults. Trust Agreement § 804. Section 108(b) of the Recovery Act eliminated this statutory and contractual right: "This Act supersedes and annuls any insolvency or custodial provision included in the enabling or other act of any public corporation, including Section 17 of

[the Authority Act]." Recovery Act § 108(b).[26] The Recovery Act does not provide for any means of compensation for taking this contractual right.

Plaintiffs' claim falls squarely within the United States Supreme Court's definition of a facial takings challenge: "a claim that the mere enactment of a statute constitutes a taking," as opposed to an as-applied claim "that the particular impact of government action on a specific piece of property requires the payment of just compensation." *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 494 (1987). Accordingly, plaintiffs' facial takings claim became ripe the moment the Recovery Act was passed. See *Suitum v. Tahoe Reg'l Planning Agency*, 520 U.S. 725, 736 n.10 (1997) (facial takings challenges "are generally ripe the moment the challenged regulation or ordinance is passed"); *Asociacion de Suscripcion Conjunta del Seguro de Responsabilidad Obligatorio v. Juarbe-Jimenez*, 659 F.3d 42, 50-51 (1st Cir. 2011) (facial takings challenge becomes ripe "at the time the offending statute or regulation is enacted or becomes effective"); *accord Pharm. Care Mgmt. Ass'n v. Rowe*, 429 F.3d 294, 307 (1st Cir. 2005).

Having concluded that jurisdiction is proper, the Court turns to the Commonwealth defendants' motion to dismiss pursuant to Rule 12(b)(6). "The sole inquiry under Rule 12(b)(6) is whether, construing the well-pleaded facts of the complaint in the light most favorable to the plaintiffs, the complaint states a claim

---

[26] Because plaintiffs' contractual right to seek the appointment is nothing more than the incorporation of plaintiffs' statutory right, section 108(b)'s annulment of the statutory right consequently eliminated the contractual right.

for which relief can be granted." *Ocasio-Hernandez*, 640 F.3d at 7.

The Takings Clause of the Fifth Amendment provides that "private property [shall not] be taken for public use, without just compensation." U.S. Const, amend. V. The Takings Clause applies to the Commonwealth of Puerto Rico through the Fourteenth Amendment. *Fideicomiso De La Tierra Del Caño Martin Peña v. Fortuño*, 604 F.3d 7, 12 (1st Cir. 2010). The purpose of the Takings Clause regime is to bar the government "from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 537 (2005) (quoting *Armstrong v. United States*, 364 U.S. 40, 49 (1960)). The United States Supreme Court identifies two categories of takings that require just compensation: (1) a direct taking, which includes either a "direct government appropriation or physical invasion of private property," and (2) a regulatory taking, which is when a "government regulation of private property ... [is] so onerous that its effect is tantamount to a direct appropriation or ouster." *Id.*

Contracts are a form of property for purposes of the Takings Clause. *U.S. Trust Co.*, 431 U.S. at 19 n.16 ("Contract rights are a form of property and as such may be taken for a public purpose provided that just compensation is paid."); *Lynch v. United States*, 292 U.S. 571, 579 (1934) ("Valid contracts are property" for purposes of the Takings Clause, "whether the obligor be a private individual, a municipality, a state, or the United States."); *Adams v. United States*, 391 F.3d 1212, 1221-22 (Fed. Cir. 2004) ("When the Government and private parties contract ... the private party

usually acquires an intangible property interest within the meaning of the Takings Clause in the contract. The express rights under this contract are just as concrete as the inherent rights arising from ownership of real property, personal property, or an actual sum of money.").

The Commonwealth defendants contend, without citing authority for support, that "there can be no 'taking' of a right that has never been triggered." (Civil No. 14-1518, Docket No. 108 at p. 18.) They then reason that plaintiffs' Takings Clause claim fails because plaintiffs' contractual right to seek the appointment of a receiver is triggered only upon default and PREPA has not defaulted. *Id.* The Commonwealth defendants' argument is unpersuasive and misunderstands the basics of contracts law. A contract may have a condition, which is an event that must occur before performance pursuant to the contract becomes due. Restatement (Second) of Contracts § 224 (1981). Here, PREPA defaulting is a condition on plaintiffs' contractual right to seek the appointment of a receiver. *See* P.R. Laws Ann. tit. 22 § 207; Trust Agreement § 804. Accordingly, plaintiffs may not seek the appointment of a receiver until PREPA defaults (*i.e.*, they may not seek performance of the contract until the condition is met). This condition does not affect the existence of plaintiffs' contractual right to seek the appointment of a receiver. This contractual right is a promise they bargained for and relied upon when purchasing PREPA bonds pursuant to the Authority Act and the Trust Agreement.

The Commonwealth defendants next attempt to apply the regulatory takings analysis to plaintiffs' claim. (Civil No. 14-1518, Docket No. 95-1 at p. 27.) "A

regulatory taking transpires when some significant restriction is placed upon an owner's use of his property for which 'justice and fairness' require that compensation be given." *Philip Morris, Inc. v. Reilly*, 312 F.3d 24, 33 (1st Cir. 2002) (citing *Goldblatt v. Town of Hempstead, N.Y.*, 369 U.S. 590, 594 (1962)). Here, there is no regulation or "restriction" placed on plaintiffs' contractual right to seek the appointment of a receiver. Rather, section 108(b) of the Recovery Act totally eliminated the contract provision that gave plaintiffs the right. Thus, by enacting section 108(b) of the Recovery Act, the Commonwealth appropriated plaintiffs' contractual right to seek the appointment of a receiver. This is a direct taking. The Court therefore declines to engage in a regulatory takings analysis and concludes that plaintiffs plausibly state a claim for declaratory relief that section 108(b) of the Recovery Act effects a taking without just compensation of plaintiffs' property in violation of the Takings Clause.

B. Plaintiffs' Takings Clause Claim Based on Their Liens on PREPA Revenues Fails to State a Claim as a Facial Challenge and is Unripe as an As-Applied Challenge

Plaintiffs next seek a declaratory judgment that sections 129(d) and 322(c) of the Recovery Act effectuate a taking without just compensation of their lien on PREPA revenues in violation of the Takings Clause. (Civil No. 14-1518, Docket No. 85 at ¶ 62.) Plaintiffs allege that their PREPA bonds are secured by a pledge of all or substantially all of the present and future net revenues of PREPA. *Id.* at ¶ 3. If PREPA files for debt relief pursuant to Chapter 3 of the Recovery Act, the special court may authorize PREPA to obtain credit "secured by a senior or equal lien on

[PREPA's] property that is subject to a lien" if, among other things, "the proceeds are needed to perform public functions" or "there is adequate protection of the interest of the holder of the [previous] lien." Recovery Act § 322(c). Section 129(d) of the Recovery Act disposes of the "adequate protection" requirement when the "police power" justifies it. *Id.* § 129(d).

The relief plaintiffs seek indicates that they are bringing a facial takings challenge: they request a declaration that sections 129(d) and 322(c) of the Recovery Act "effectuate a taking of the[ir] lien." (Civil No. 14-1518, Docket No. 85 at ¶ 62.) In other words, they claim that the "mere enactment" of sections 129(d) and 322(c) constitutes a taking. *See Keystone Bituminous*, 480 U.S. at 494 (defining facial takings challenge). But plaintiffs' allegations to not support this claim. Rather, plaintiffs allege that the Recovery Act authorizes the special court to authorize PREPA to prime plaintiffs' lien. *See* Civil No. 14-1518, Docket No. 85 at ¶ 33; Recovery Act § 322(c). They have not alleged that their lien has been primed. That is to say, plaintiffs still today have a senior lien on PREPA revenues. This is unlike their contractual right to seek the appointment of a receiver, which plaintiffs do not have today because section 108(b) of the Recovery Act expressly eliminated that right. *See supra* Part VI.A. Thus, when analyzed as a facial takings challenge, plaintiffs fail to state a claim upon which their sought-after declaratory relief (that sections 129(d) and 322(c) of the Recovery Act effectuate a taking without just compensation) can be granted because they fail to allege an actual taking.

Characterizing plaintiffs' claim as an as-applied challenge, however, leads to a different conclusion. An

as-applied facial takings challenge is a claim "that the particular impact of government action on a specific piece of property requires the payment of just compensation." *Keystone Bituminous*, 480 U.S. at 494. This definition fits plaintiffs' factual allegations: plaintiffs allege that if PREPA files pursuant to Chapter 3 of the Recovery Act and the special court authorizes PREPA to grant a lien on PREPA revenues senior to plaintiffs' lien, that action by the special court will amount of a taking of plaintiffs' lien and will require the payment of just compensation. While facial takings challenges are ripe the moment the challenged law is passed, *Suitum*, 520 U.S. at 736 n.10; *Asociacion de Suscripcion Conjunta*, 659 F.3d at 50-51; *Pharm. Care Mgmt. Ass'n*, 429 F.3d at 307, as-applied takings challenges must pass a higher ripeness hurdle. In *Williamson County*, the Supreme Court held that plaintiffs raising as-applied takings challenges must meet two special ripeness requirements: (1) that the relevant government entity "has reached a final decision regarding the application of the regulations to the property at issue," and (2) that the plaintiffs pursued any "adequate procedure for seeking just compensation." *Williamson Cnty. Reg'l Planning Comm'n v. Hamilton Bank of Johnson City*, 473 U.S. 172, 186, 195 (1985); *accord Downing/Salt Pond Partners, L.P.*, 643 F.3d at 20-21. Here, the special court is the government entity tasked with deciding whether PREPA may prime plaintiffs' lien. *See* Recovery Act § 322(c) ("The [special c]ourt, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on the petitioner's property that is subject to a lien ...."). Plaintiffs have not alleged that the special court made a final decision regarding the priming of their

lien. Thus, when analyzed as an as-applied takings challenge, plaintiffs' claim fails the first *Williamson County* ripeness requirement and is therefore unripe.[27]

C. Takings Clause Conclusion

For the foregoing reasons, the Court **DENIES** the Commonwealth defendants' motion to dismiss, (Civil No. 14-1518, Docket No. 95), as to the Franklin and Oppenheimer Rochester plaintiffs' Takings Clause claim based on their contractual right to seek the appointment of a receiver, and **GRANTS** the Commonwealth defendants' motion to dismiss, (Civil No. 14-1518, Docket No. 95), as to plaintiffs' Takings Clause claim based on their lien on PREPA revenues.

VII. CONCLUSION

In Civil Case No. 14-1518, the Court orders as follows:

1. The Commonwealth defendants' motion to dismiss, (Docket No. 95), is **DENIED** as to the Franklin and Oppenheimer Rochester plaintiffs' preemption and Contract Clause claims.

2. The Commonwealth defendants' motion to dismiss, (Docket No. 95), is **GRANTED** as to plaintiffs' stay of federal court proceedings claim. The stay

---

[27] This result is not affected by the fact that plaintiffs seek declaratory relief, as opposed to money damages. *See Garcia-Rubiera v. Calderon*, 570 F.3d 443, 451-54 (1st Cir. 2009) (applying both *Williamson County* ripeness prongs to takings claim for declaratory and injunctive relief); *Golemis v. Kirby*, 632 F. Supp. 159, 164 (D.R.I. 1985) ("[The *Williamson County*] ripeness analysis would be completely neutered if its holding were applied to damage claims alone.").

of federal court proceedings claim is unripe and is therefore **DISMISSED WITHOUT PREJUDICE.**

3. The Commonwealth defendants' motion to dismiss, (Docket No. 95), is **DENIED** as to plaintiffs' Takings Clause claim based on their contractual right to seek the appointment of a receiver, and **GRANTED** as to plaintiffs' Takings Clause claim based on their lien on PREPA revenues. The Takings Clause claim based on plaintiffs' lien on PREPA revenues is **DISMISSED WITHOUT PREJUDICE.**

4. PREPA's motion to dismiss, (Docket No. 97), is **GRANTED** as to all claims to the extent that they are asserted against PREPA. PREPA is **DISMISSED** from this case because plaintiffs lack standing against it.

5. Plaintiffs' motion for summary judgment, (Docket No. 78), is **GRANTED** as to plaintiffs' preemption claim and **DENIED** as to plaintiffs' stay of federal court proceedings claim.

In Civil Case No. 14-1569, the Commonwealth defendants' motion to dismiss, (Docket No. 29), is **DENIED** as to plaintiff BlueMountain's preemption and contract clauses claims, and **GRANTED** as to BlueMountain's stay of federal court proceedings claim. The stay of federal court proceedings claim is unripe and is therefore **DISMISSED WITHOUT PREJUDICE.**

The Recovery Act is preempted by the federal Bankruptcy Code and is therefore void pursuant to the Supremacy Clause of the United States Constitution. The Commonwealth defendants, and their successors in office, are permanently enjoined from enforcing the Recovery Act.

IT IS SO ORDERED.

San Juan, Puerto Rico, February 6, 2015.

s/ Francisco A. Besosa
FRANCISCO A. BESOSA
UNITED STATES DISTRICT JUDGE

English Version of the "Puerto Rico Public Corporation Debt Enforcement and Recovery Act"

To create the "Puerto Rico Public Corporation Debt Enforcement and Recovery Act," in order to establish a debt enforcement, recovery, and restructuring regime for the public corporations and other instrumentalities of the Commonwealth of Puerto Rico during an economic emergency; to create chapter 1 of the Act, titled General Provisions, chapter 2, titled Consensual Debt Relief, chapter 3, titled Debt Enforcement, and chapter 4, titled Effectiveness of the Act; to establish the definitions, interpretation and evidentiary standards applicable to the Act; to establish provisions regarding jurisdiction and procedure, including the creation of the Public Corporation Debt Enforcement and Recovery Act Courtroom of the Court of First Instance, San Juan Part, the powers and responsibilities of said court, the parameters that will govern eligibility for processes under chapter 2 and chapter 3 of the Act and to establish provisions on service of process, applicability of the rules of civil procedure, objections and appeals, among others; to establish provisions regarding creditor protection and governance, including limitations on avoidance actions, recovery on avoidance actions and the appointment of an emergency manager, among others; to establish the rules that will govern chapter 2, Consensual Debt Relief, including the objectives of a consensual debt relief transaction, the creation an oversight committee to monitor the public corporation's compliance with the recovery program, the court approval of the consensual debt relief transaction, the suspension of remedies during the suspension period and the financing of the public corporation during said period, among others; to

establish the rules that will govern chapter 3, Debt Enforcement, including the petition for relief, the automatic stay, the eligibility hearing, the enforcement of claims by foreclosure transfer, the confirmation requirements, the creation of the creditors' committees and various additional provisions relating to the assets, liabilities, contracts and powers of the petitioner, among others; and to other ends.

STATEMENT OF MOTIVES

A. Current State of Fiscal Emergency

The fiscal situation of the Government of the Commonwealth of Puerto Rico for the last six years has been the most critical the country has undergone in its history. In January 2013, the General Fund deficit for fiscal year 2012-2013 was projected to surpass $2.2 billion. By means of various measures implemented by this Administration, said deficit was reduced to approximately $1.29 billion as of June 30, 2013. For the current fiscal year 2013-2014, this Legislative Assembly approved various measures of fiscal discipline that permitted a reduction, with legislative approval, of appropriations in an amount of $170 million below budgeted amounts. Notwithstanding, and as informed by the Treasury Department, at June 10, 2014, the projected collections for the current fiscal year were $320 million below the projected amount, for which measures have been implemented in order to close the gap and achieve the goal of closing the current fiscal year with a deficit of $650 million.

The situation at the public corporations in January 2013 was no different, as the combined deficit of the country's three main public corporations (the Electric Power Authority (hereinafter "PREPA"), the Aqueduct and Sewer Authority (hereinafter "PRASA") and the

Highways and Transportation Authority (hereinafter "PRHTA")) for fiscal year 2012-2013 was approximately $800 million, all of them with a combined debt adding up to $20 billion. This Administration implemented various measures in order to improve the finances of these public corporations in order to assist them in again becoming financially self-sufficient.

For example, on February 27, 2013, this Administration completed the transaction that involved the lease of the Luis Munoz Marin International Airport by means of a public-private partnership, which strengthened the fiscal position of the Ports Authority and reduced the financial difficulties of said public corporation and Government Development Bank for Puerto Rico (hereinafter "GDB") by repaying in excess of $490 million owed to, or guaranteed by, GDB; on June 25, 2013, acts 30-2013 and 31-2013 were approved increasing the revenues of the PRHTA by approximately $270 million and allowing such public corporations to begin amortizing all of the lines of credit owed to GDB, currently in an amount of approximately $1.8 billion, and cover operational expenses; in July 2013, the Governing Board of PRASA implemented an average increase of 60% in water rates, approved by the prior administration, to cover operational expenses and improve its debt service coverage, which has allowed that public corporation to stop depending on General Fund subsidies to cover its operational deficits; and, notwithstanding the predictions, in August 2013, PREPA was able to place a bond issue of $673 million that allowed it to partially finance its capital improvement program.

Notwithstanding all of the foregoing, the measures taken with the General Fund, as well as with the public corporations, have not been enough to address the economic and fiscal problems of Puerto Rico. As the public is aware, for the first time in our constitutional history, the credit of the Commonwealth has been compromised as a result of the downgrade to non-investment grade of its general obligation bonds by the principal rating agencies, notwithstanding all of the previously mentioned governmental measures. The three principal rating agencies downgraded below investment grade the Commonwealth's general obligation bonds, and the bonds of the majority of its instrumentalities and public corporations, including GDB, PREPA, PRASA, PRHTA, and the Public Buildings Authority. The public debt's loss of its investment grade rating places the economic and fiscal health of the people of Puerto Rico at risk, and improperly compromises the credit of the Central Government and its public corporations.

Also, during fiscal year 2013-2014, the liquidity of the government and GDB was adversely affected by various factors that significantly limited the available resources and financial flexibility of the government to cover its governmental operations. These factors include a significant increase in the interest rates and yields of both Commonwealth obligations and those of its instrumentalities and public corporations, limited access by these entities to the United States capital markets and a marked reduction in the island's capital markets. In addition, this crisis limited GDB's ability to provide interim financing to public corporations and other entities. In light of this, local and international private financial institutions, which in the past had served as a source of interim liquidity for the Central

Government and the public corporations, have significantly reduced and continue to reduce the credit extended to the Commonwealth and its public corporations, and no longer are a viable alternative for obtaining interim financing. The reduction in capital market access and in the credit provided by private financial institutions, has also limited the volume of debt that can be issued and, as a result, makes it impossible for the government to depend on financings to cover the cost of its governmental operations.

GDB, which has the statutory role of serving as financial adviser and fiscal agent to the Government of the Commonwealth, its instrumentalities, municipalities, and public corporations, and has also served as a source of interim financing for all parts of the governmental apparatus, has seen its liquidity affected precisely by its financing of the operational deficits of various public corporations. In GDB's financial statements for the fiscal year ended June 30, 2013, the auditors emphasize that GDB has $6.9 billion in loans to the Commonwealth and its public corporations, which constitutes 48% of GDB's total assets. On the other hand, loans to municipalities totaled $2.212 billion, or 15% of GDB's total assets. Therefore, the liquidity and financial condition of GDB significantly depends upon the ability of the Commonwealth and its public corporations to repay their debt, which, as stated before, has been severely affected.

Based on this situation, the present Administration took various measures to improve GDB's liquidity. For example, in March 2014, the Commonwealth made a historic bond issue of its general obligation bonds in the amount of $3.5 billion, the net proceeds of which

were mainly used to repay the Commonwealth's obligations with GDB. Also, Act No. 24-2014 was approved so that GDB, among others, could require certain governmental entities to transfer the balance of cash accounts maintained at private sector institutions to GDB. Also, said Act prohibits GDB from approving loans to public corporations that are unable to show that they have the sources of revenue sufficient to cover the debt service of the new financing. As a result, that law has the effect of imposing fiscal discipline on public entities and preserves the liquidity and financial situation of GDB. Although these measures, together with other efforts, have increased GDB's liquidity, it still lacks sufficient financial strength, on its own, to satisfy the current financing needs of the Government of the Commonwealth and, in particular, of its public corporations, especially with the limited market access of these entities.

As a result of this liquidity situation which has exacerbated the difficult fiscal and financial outlook of the country, this Administration has proposed the approval of a balanced budget for the Commonwealth, without the financing of operational deficits nor debt refinancing for fiscal year 2014-2015. In addition, various expense reduction and operational reorganization measures have been taken at the agency and public corporation level, including the enactment of the Special Law for the Fiscal and Operational Sustainability of the Government of the Commonwealth of Puerto Rico, Act 66-2014, so that the Central Government as well as the public corporations may be able to cover their operational expenses with revenues collected by such entities and not by means of non-recurring funds, such as loans and debt

refinancing. Act 66-2014 declared a fiscal emergency for the country for:

> the fiscal and economic recovery after the downgrade of Puerto Rico's credit and the reduction of collections that affects the liquidity of the State, safeguarding the constitutional mandate for the payment of interest and amortization of the public debt, it is hereby adopted a plan for the management of the consequences of the same and to establish a structured administration that will permit the country to meet its obligations. Similarly, the continuity of the public function is assured in essential areas of health, safety, education, social work and development, among others, as well as the rendering of those services necessary and indispensable for the populace. This law will have as its public policy the restoration of the public credit of the commonwealth of Puerto Rico through the elimination, in the short term, of the General Fund deficit and the improvement in the fiscal condition of the public corporation, without resorting to the dismissal of regular or career public employees, nor affecting the essential functions of the government agencies that provide security, education, health or social work. This structured plan is indispensable to protect the availability of cash to the Commonwealth of Puerto Rico in such a manner so that the provision of indispensable services the populace receives is not affected. This plan considers the

> challenges that Puerto Rico confronts to restore the public credit and address the uncertainty surrounding the duration, scope and cost of access to the capital markets in the absence of an investment grade rating.

Although the implementation of Act 66-2014 will result in approximately $230 million in combined savings for all public corporations, such fiscal control measures will not be sufficient to address the immediate fiscal situation of many public corporations of the country. Public corporations of the Commonwealth of Puerto Rico that provide essential public services, PREPA being the most dramatic example, today face significant operational, fiscal, and financial challenges. During the past years, these public corporations have issued bonds in the capital markets or obtained loans, guarantees, or other financial support from the Government Development Bank for Puerto Rico ("GDB") or private financial institutions to cover recurring budget deficits as result of the prolonged weakness in the Commonwealth's macroeconomic conditions, their inefficiencies, and their high operating costs. These fiscal and financial conditions have also been exacerbated by the needs of these public corporations to invest substantial amounts in their capital improvement plans, in many instances required by applicable federal regulation. As a result of this, some of these public corporations are also burdened with a heavy debt load as compared to the resources available to cover the corresponding debt service.

At present, as previously discussed, these public corporations have limited access to the capital markets and their ability to repay outstanding financings is

severely compromised. At the same time and contrary to past improper practices, the Government of Puerto Rico has implemented responsible public policies pursuant to which GDB will no longer provide financing to cover operating deficits of the public corporations, and neither will the Department of the Treasury of the Commonwealth because these are not financially sound practices, and GDB and the Central Government are not in a position to cover such deficits. As previously indicated, under this Administration, the public corporations have been taking the measures necessary to achieve economic self-sufficiency, because reaching such self- sufficiency is fundamental for the new policy of responsibility required by the people of Puerto Rico. That being said, the lack of access to financing and deficit funding may culminate in some public corporations becoming unable to pay their debts when due, honor their other contractual obligations, and continue to perform important public functions such as providing required maintenance and improvements to existing critical infrastructure or making new investments necessary to the continuation of these vital services and compliance with regulatory requirements.

As recognized by this Legislative Assembly upon the enactment of Act Nos. 30 and 31 of 2013, which, as previously indicated, assigned new revenues to PRHTA, that public corporation has been facing a precarious situation for some years now due to the general reduction of its revenues exacerbated by the increases in the costs of its operations. Based on that public corporation's audited financial statement for fiscal years 2010 through 2013, PRHTA had accumulated operational losses (before depreciation) of $349 million. These deficiencies were covered by GDB

during the past years in order for that public corporation to continue operating and making payments to its principal creditors. During the past four years from 2009-2012, PRHTA's fiscal outlook worsened due to a severe pattern of covering its operational mismatches with GDB lines of credit, that, during such period, added up to $2.113 billion without having identified resources for the repayment of such obligations.

In a separate matter, this Legislative Assembly has also recognized, through the Puerto Rico Transformation and Energy RELEIF Act, Act 57-2014, that high energy costs, which reached their highest levels at the end of 2012 at $0.31 per kilowatt hour, have crippled our economic development and that these high costs are a result of PREPA's dependence on oil for purposes of generating electricity and its highly leveraged structure, which for several years has created difficulties in its ability to implement necessary capital improvements to the power generation, transmission, and distribution systems. PRHTA and PREPA exemplify the nature and scope of the crisis that certain of our public corporations currently face that may lead to an unprecedented failure in the ability of some public corporations to safeguard the public and promote the general welfare of the people by continuing to provide essential government services while at the same time honoring their debt and other obligations.

As previously mentioned the financial challenges facing some of the public corporations have been further exacerbated by the Central Government's own fiscal and economic challenges. The budget deficits incurred over decades, prolonged economic recession

(since 2006), a high rate of unemployment that reached 16% in 2010, population decline, and high levels of debt and pension obligations, have contributed to the financial problems of the public corporations. All of these factors have led to widening of credit spreads for public sector debt and the ratings downgrades, all as previously discussed. This, in turn, has further strained the liquidity of the Commonwealth and its public corporations and adversely affected their access to the capital markets and private sources of financing, as well as their borrowing costs.

This Legislative Assembly has time and again demonstrated its willingness to act to address the financial and economic challenges of the Commonwealth and its public corporations. This Legislative Assembly has enacted comprehensive reforms of the Employees Retirement System through Act No. 3-2013, as amended, the Teachers Retirement System through Act No. 160-2013, and the Judiciary Retirement System through Act No. 162-2013 in order to ensure retirees will continue to receive their pensions while addressing the Commonwealth's cash flow needs. This Legislative Assembly also enacted comprehensive energy reform legislation, Act 57-2014, in order to promote the economic development and wellbeing of the people of the Commonwealth.

In light of the financial situation of the Commonwealth and the Administration's goal to balance the Commonwealth's General Fund, Governor Alejandro Garcia Padilla recently announced that the Commonwealth's public corporations would be required to achieve financial self-sufficiency in the near future. This self-sufficiency, however, may not be achieved through increases in basic rates, which are already

excessively high, hinder and depress economic activity and development. Given that public corporations no longer can rely on GDB loans, Commonwealth subsidies, or rate increases to cover their operating deficits, they may be unable to pay their debts as they come due and honor their other contractual obligations, while at the same time trying to meet their obligations to provide services to our populace. If the public corporations were to default on their obligations in a manner that permits creditors to exercise their remedies in a piecemeal way, the lack of an effective and orderly process to manage the interests of creditors and consumers, would threaten the ability of the Commonwealth's government to safeguard the interests of the public to continue receiving essential public services and promote the general welfare of the people of Puerto Rico.

The challenges described herein are not issues that can be addressed in the future in a gradual and measured manner over an extended period of time. We have inherited them and they are with us today, constituting a real and palpable threat to the government's ability to protect and promote the general welfare of the people of Puerto Rico now, and therefore establish a current state of fiscal emergency.

B. Insufficiency of Current Commonwealth Laws and Inapplicability of Federal Law

At present, there is no Commonwealth statute providing an orderly recovery regime for public corporations that may become insolvent. The enabling acts of PREPA and PRASA, for example, contain provisions that contemplate the appointment by a court of a receiver in the context of a default that, under the direction of a court, would take over the

operations of the public corporation and apply its operating revenues in the manner ordered by the court. The receiver would remain in place until such time as all defaults of the public corporation are cured. These general provisions are inadequate to address the complexities involved in a recovery process in the event of an insolvency. They lack the rules and procedures necessary to properly and equitably manage the recovery process of a public corporation for the benefit and protection of all stakeholders.

At the same time, the provisions of the federal laws applicable to corporations in state of insolvency are inapplicable to the Commonwealth's public corporations.

This Act addresses the existing statutory gap, consistent with Commonwealth and federal constitutional requirements, and enables the Commonwealth's public corporations to address their particular fiscal and financial emergencies in a manner that maximizes value to creditors while protecting public functions important for the public health, safety and welfare, and positioning the Commonwealth to grow its economy for the benefit of all stakeholders collectively. This legislation acknowledges the complexity of these types of proceedings and provides special procedures by which the Chief Justice of the Puerto Rico Supreme Court may designate particular judges to oversee these types of proceedings who may, in turn, designate special commissioners with the required expertise to assist in their resolution. This is not a bankruptcy act, but an orderly debt enforcement act for the eligible public corporations.

C. Constitutional Basis

This legislation is consistent with guidance provided by the United States Supreme Court (the "U.S. Supreme Court") with respect to the proper rules and procedures for carrying out the financial recovery of entities ineligible for relief under the applicable federal laws.

As discussed below, the Commonwealth has the power to enact a statute that allows a public corporation to modify the terms of its debt with the consent of a substantial number of affected creditors or through a court-supervised proceeding because the U.S. Supreme Court has acknowledged the power of states to enact their own laws for entities Congress has not rendered eligible under applicable federal law. In addition, Puerto Rico has the police power to enact orderly debt enforcement and recovery statutes when facing an economic emergency, since Congress enacted legislation in 1950 and 1952 granting the Commonwealth the power to govern under its own constitution.

These being the circumstances, states have the power to enact their own laws to provide a process for adjusting debts. States have also enacted laws permitting insurance companies and banks ineligible under provisions like chapters 9 and 11 of title 11 of the United States Code to adjust their debts.

States are also able to enact their own enforcement and adjustment statute under their police power. In Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942), the U.S. Supreme Court explained the state retains police power with respect to the financial wellbeing of the state: "If a State retains police power with respect to building and loan associations ...

because of their relation to the financial well-being of the State, and if it may authorize the reorganization of an insolvent bank upon the approval of a state superintendent of banks and a court, ... a State should certainly not be denied a like power for the maintenance of its political subdivisions and for the protection not only of their credit but of all the creditors...." Faitoute Iron & Steel Co., 315 U.S. at pages 313-14. This police power extends not only to the enactment of an adjustment statute where Congress has failed to act, but also to the use of the police power during periods of emergency.

The Commonwealth has sovereign authority to enact its own laws, as long as the statute does not conflict with our own Constitution, the Constitution of the United States or applicable federal law. With the passage of Public Law 600, Congress authorized the Commonwealth to draft its own constitution. The legislation was offered in the "nature of a compact so that the people of Puerto Rico may organize a government pursuant to a constitution of their own adoption." In approving the proposed constitution, Congress noted: "Within this framework, the people of Puerto Rico will exercise self-government. As regards local matters, the sphere of action and the methods of government bear a resemblance to that of any State of the Union."

Courts have recognized this sovereign authority of the Commonwealth. The U.S. Supreme Court has held that the Commonwealth is "sovereign over matters not ruled by the Constitution." The Court has reiterated this holding on two occasions. Specifically, in Examining Board of Engineers v. Flores de Otero, 426 U.S. 572, 594 (1976), the Court stated that "The

purpose of Congress in the 1950 and 1952 legislation was to accord to Puerto Rico the degree of autonomy and independence normally associated with a state of the union." In Rodriguez v. Popular Democratic Party, 457 U.S. 1, 8 (1982), the Court further explained: "... Puerto Rico ... is an autonomous political entity, sovereign over matters not ruled by the Constitution." Moreover, in Cordova & Simonpietri Insurance Agency, Inc. v. Chase Manhattan Bank, 649 F.2d 36, 41 (1st Cir. 1981), a case that was cited positively by the U.S. Supreme Court in U.S. v. Lara, 541 U.S. 193, 204 (2004), the United States Court of Appeals for the First Circuit concluded that:

> In sum, Puerto Rico's status changed from that of a mere territory to the unique status of Commonwealth. And the federal government's relations with Puerto Rico changed from being bounded merely by the territorial clause, and the rights of the people of Puerto Rico as United States citizens, to being bounded by the United States and Puerto Rico Constitutions, Public Law 600, the Puerto Rican Federal Relations Act and the rights of the people of Puerto Rico as United States citizens.

The Commonwealth Constitution expressly recognizes the Commonwealth's police power. Under Article II, Section 18, citizens of the Commonwealth are given the right to organize and bargain collectively. That right, however, does not impair the state's police power: "Nothing herein contained shall impair the authority of the Legislative Assembly to enact laws to deal with grave emergencies that clearly imperil the public health or safety or essential public services." In

addition, Article II, Section 19 more explicitly recognizes the police power of the Commonwealth: "The power of the Legislative Assembly to enact laws for the protection of the life, health and general welfare of the people shall likewise not be construed restrictively."

Similarly, the Legislative Assembly was given the power to create the Commonwealth courts by Congress in 1950 and 1952 when Congress enacted legislation granting Puerto Rico Commonwealth status and the power to govern under its own constitution. Section 2 of Article V of the Commonwealth Constitution grants the Legislative Assembly the authority to create the Commonwealth court. Therefore, the Legislative Assembly has the power to enact, and a Puerto Rico court has the power to enforce, an orderly debt enforcement statute.

D. Purpose and Objectives of the Act

This Legislative Assembly finds that the current fiscal emergency situation requires legislation that allows public corporations, among other things, (i) to adjust their debts in the interest of all creditors affected thereby, (ii) provides procedures for the orderly enforcement and, if necessary, the restructuring of debt in a manner consistent with the Commonwealth Constitution and the U.S. Constitution, and (iii) maximizes returns to all stakeholders by providing them going concern value based on each obligor's capacity to pay. It further believes that the public corporations can be restored to a position of solvency and creditworthiness by postponing or reducing debt service with the consent of a supermajority of the creditors as part of a recovery program, as contemplated by chapter 2 of this Act.

This Legislative Assembly recognizes that if the public corporations fail to use the revenues that have been pledged to the payment of debt service to maintain basic public services that are necessary to preserve the public health, safety, and welfare of our citizens, they will likely be unable to honor their debt. This Act also recognizes that if an orderly debt enforcement and recovery process is not in place, there will likely be outcomes that do not balance fairly the interests of all the stakeholders. To address these challenges in a manner that treats debt holders fairly and balances the best interests of creditors with the interest of the Commonwealth to protect its citizens and to grow and thrive for the benefit of its residents, this Legislative Assembly has decided to enact a law that is consistent with the precepts espoused by the courts of the Commonwealth and the United States.

E. Summary of the Act

The Act contemplates two types of procedures to address a public corporation's debt burden. The first is a consensual debt modification procedure that would culminate in a recovery program (chapter 2 of this Act) and the second is a court-supervised procedure that would culminate in an orderly debt enforcement plan (chapter 3 of this Act). A public corporation can seek relief under either chapter 2 or chapter 3 at the same time or sequentially. This Act is designed in many respects to mirror certain key provisions of title 11 of the United States Code, and courts and stakeholders are encouraged to review and consider existing precedent under title 11 of the United States Code, where applicable, when interpreting and applying this Act.

Eligibility

The following entities are not eligible to seek relief under this Act: the Commonwealth (for the avoidance of doubt, neither the general obligation debt of the Commonwealth, nor any debt guaranteed by the Commonwealth shall be subject to the Act); the seventy-eight municipalities of the Commonwealth; GDB and its subsidiaries, affiliates, and ascribed entities; the Children's Trust; the Employees Retirement System; the Judiciary Requirement System; the Municipal Finance Agency; the Municipal Finance Corporation; the Puerto Rico Industrial Development Company; the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority; the Puerto Rico Infrastructure Financing Authority; the Puerto Rico Sales Tax Financing Corporation; the Teachers Retirement System; and the University of Puerto Rico.

Summary of Chapter 1 of the Act

Chapter 1 of the Act establishes the general provisions of the law and includes three subchapters, the first entitled "Title, Purposes, Nomenclature, and Interpretation," the second "Jurisdiction and Procedure," and the third "Creditors' Protections and Governance." Subchapter I includes provisions related to, among other things, definitions, standards of interpretation and evidence, a savings clause, and inapplicability of other laws. Subchapter II establishes the norms regarding jurisdiction, the powers and responsibilities of the Court, eligibility, service of process, and appeals, among others. Subchapter III contains provisions concerning constitutional safeguards for creditors, the role of GDB in proceedings conducted under the Act, the power of the

Governor to appoint an Emergency Manager, and the basic tools available to an eligible public corporation availing itself of the Act, such as continued operations and limited recovery of setoffs and actual fraudulent transfers.

Summary of Chapter 2 of the Act

General. Chapter 2 provides a mechanism for a public corporation to adopt a recovery program and seek a market-led solution for debt relief, based on the recovery program, that binds all debt holders with the consent of a supermajority of debt holders. The recovery program contemplated by chapter 2 will have as its objectives: to enable an eligible obligor to become financially self-sufficient; to allocate equitably among all stakeholders the burdens of the recovery program; and to provide the same treatment to all creditors unless a creditor agrees to a less favorable treatment.

Chapter 2 was designed based on jurisprudence that has determined that no violation of the constitutional prohibition on the impairment of contracts exists upon the enactment of a debt adjustment regime that complies with the following principal characteristics: the existence of a fiscal emergency that necessitates the enactment of this legislation; a supermajority vote in order to bind the minority; the creation of an impartial oversight board to supervise compliance with the recovery program; ratable distributions; and court approval.

Commencement and Eligibility. The chapter 2 process begins when the governing body of a public corporation and GDB, or GDB upon the Governor's request, as the case may be, authorize the public corporation to seek consensual debt relief from holders of specified debt instruments (which chapter 2

identifies as the affected debt instruments). Any government entity, other than those specifically excluded (see above), is eligible to commence a recovery process under chapter 2 of this Act.

Scope of Relief. The relief available under chapter 2 consists of any combination of amendments, modifications, waivers, or exchanges (collectively referred to as amendments) to the affected debt instruments, so long as the amendments are coupled with the public corporation's commitment to be bound by the recovery program. Amendments may includevarious features such as interest rate adjustments, maturity extensions, debt relief, or other revisions to affected debt instruments.

Suspension of Remedies. After a public announcement of the suspension period is made, all remedies otherwise granted to holders of, parties with a beneficial interest in, and trustees and indenture trustees and similar representatives related to the affected debt instruments are temporarily suspended for a sufficient period of time to allow the public corporation to engage in discussions with stakeholders, seek the required consent from holders, and obtain court approval of the amendments. The public corporation shall have the power through court process to enforce the temporary suspension of remedies.

Recovery Program. A public corporation seeking approval of a consensual debt relief transaction must commit to and formulate a recovery program. The recovery program must allow the public corporation to become financially self-sufficient based on financial and operational adjustments as may be necessary or appropriate to allocate the burdens of such consensual debt relief equitably among all stakeholders. The

recovery program, which may include interim milestones and performance targets, will necessarily require burden sharing by affected stakeholders and may also include measures designed to improve operating margins; increase operating revenues; reduce operating expenses; transfer or otherwise dispose of existing operating assets; acquire new operating assets; and close down or restructure existing operations or functions.

Required Consent of Debt Holders. Proposed amendments to the affected debt instruments must be submitted to the holders of such debt instruments for consent or approval. If holders of at least half of the amount of debt entitled to vote or consent in a particular class participate in the vote or consent process and holders of at least three-quarters of the aggregate amount of debt that participate in the vote or consent solicitation approve the amendments, the public corporation may then seek court approval of the amendments for the purpose of binding all holders of such affected debt instruments to the amendments.

Court Approval. The court process is designed to be efficient and expedient in light of the consensual nature of the transaction. The designated courtroom within the Court of First Instance, San Juan Part, established by this Act will have original jurisdiction to resolve any disputes relating to any provision under chapter 2, including a consensual debt relief transaction. Upon an application by the public corporation for approval of the amendments, the court will be required to determine whether (i) the amendments proposed in such transaction are consistent with the objectives of chapter 2, and (ii) that the voting procedure was conducted in a manner

consistent with chapter 2. If the court is satisfied that these requirements have been satisfied, the court must order that the proposed amendments shall become effective immediately, and that all holders of such instruments shall be bound by the new terms of the instrument. The amendments shall be binding on the public corporation and any entity asserting claims or other rights, including anyone with a beneficial interest, in respect of affected debt instruments.

Oversight Commission. In order to monitor the public corporation's compliance with the recovery program, chapter 2 establishes an oversight commission comprised of three independent experts appointed by the Governor. The commission is also charged with the responsibility of providing periodic compliance updates to stakeholders and the public. If the public corporation fails to achieve its interim performance targets, for example, the commission may issue non-compliance findings and make recommendations for curing such non-compliance.

Summary of Chapter 3 of the Act

General. Chapter 3 addresses the debt problem of the Commonwealth's public corporations through a judicial solution requiring the same consent required in, for example, chapters 9 and 11 of title 11 of the United States Code. Chapter 3 enables each qualifying public corporation to defer debt repayment and to decrease interest and principal to the extent necessary to enable each entity to continue to fulfill its vital public functions. Collective bargaining agreements may be modified or rejected under certain circumstances and trade debt can be reduced when necessary. In designing chapter 3, this Legislative Assembly has adopted a model similar to that of

chapter 9 of title 11 of the United States Code in order to provide all stakeholders with much needed familiarity in a process wrought with uncertainty. As a result, this Legislative Assembly clearly expresses its intent that jurisprudence interpreting the provisions of chapter 9 of title 11 of the United States Code be used, to the extent applicable, for purposes of interpreting the provisions of chapter 3 of this Act.

Constitutional Basis. Notwithstanding the common concepts that this legislation shares with analogous federal law, as stated before, this legislation is not a bankruptcy statute. This legislation provides for a regime to guarantee the orderly enforcement of debts, to the extent of each such public corporation's ability to do so. To address the U.S. Supreme Court's concern about a municipality legislating the terms on which its own instrumentalities' debts can be handled, chapter 3 adopts even more stringent economic standards than Congress adopted for chapters 9 and 11 of title 11 of the United States Code. Accordingly, the underlying premise of chapter 3 is that it must serve as an orderly debt enforcement mechanism that makes creditors better off than they would be if they all simultaneously enforced their claims immediately. Primarily, chapter 3 accomplishes this task by requiring that each creditor receive (i) at least the value it would receive if all creditors were allowed simultaneously to enforce their respective claims against the public corporation, and, wherever possible, the higher going concern value of the public corporation, plus (ii) a note providing additional value based on the amount by which the public corporation's future financial results yield positive cash flow. This note serves as a protection against paying creditors less than the available value

and as a proxy for the amount each creditor could receive in the future in the absence of chapter 3.

Chapter 3 was designed based on the desire of the Commonwealth's public corporations to satisfy their contractual obligations to the maximum extent possible. Wherever practicable, chapter 3 opts to maximize distributions to creditors consistent with the execution of vital public functions, without which all creditors would be worse off. For example, in some circumstances, if pledged revenues are turned over to creditors and not used to sustain a public corporation, there may be fewer revenues in the future to pay the creditors. Assets backing employee retirement or post-employment benefit plans remain inviolable under chapter 3. Obligations for employee wages and salaries, payment for the provision of goods and services under a certain threshold (not to be lower than $1 million), and debts owing to the United States of America will be paid in full.

Commencement and Eligibility; Stay of Actions. A case under chapter 3 is commenced when a petition for relief is filed, as such concept is defined in chapter 3. To be eligible for chapter 3, a petitioner must be (i) currently unable or at serious risk of being unable to pay valid debts as they mature while performing its public functions without additional legislative or financial assistance, (ii) ineligible for relief under chapter 11 of title 11 of the United States Code and (iii) authorized to file a petition by its governing body and GDB or by GDB at the Governor's request on behalf the public corporation. The petition must contain information about the types and amounts of claims the petitioner intends to affect under its debt enforcement plan. Any actions for payment of such

claims are stayed as of the date the petition is filed, channeling their adjudication into a single forum—the designated courtroom within the Court of First Instance, San Juan Part, established by this Act. Prompt notice of the petition, the claims to be affected, and the automatic stay must be furnished to creditors, along with notice of the opportunity to volunteer to serve on a general creditors' committee to be appointed by the Court. The notice shall also include a date set by the Court for a hearing to determine whether the petitioner is eligible for relief under chapter 3 and the deadlines for filing any objections to eligibility. The eligibility hearing must take place no more than 30 days after the petition is filed.

Pendency of Case. During its chapter 3 case, the petitioner remains in possession and in control of its assets and operations. After the petition is filed, any expense the petitioner incurs in exchange for new value is an administrative expense, to be paid in full in the ordinary course, and unaffected by the petitioner's plan. The petitioner may obtain unsecured credit or incur debt in the ordinary course as an administrative expense; if the petitioner is unable to obtain credit or incur debt on those terms, chapter 3 provides the Court with the power to authorize significant further protections for lenders willing to extend credit to the petitioner.

Rejection of Contracts. The petitioner also has the power to assign or reject contracts to which it is party if the Court finds it is in the petitioner's best interests. Counterparties to rejected contracts will be left with claims for breach of contract, to be treated under the petitioner's plan. Collective bargaining agreements are subject to rejection or modification, but only where the

Court determines that absent rejection or modification the petitioner would likely become unable to perform public functions, which determination is to be made only, based on U.S. Supreme Court precedent, after the data underlying the request for rejection have been shared with union representatives and reasonable efforts to negotiate a voluntary modification have failed.

Debt Enforcement Plan. Only the petitioner or GDB, upon the Governor's request, may propose a debt enforcement plan under chapter 3. Creditors must be separated into different classes (based upon different collateral security, priorities, or rational bases for classifying similar claims separately) for treatment under the plan. Plan treatment must be such that every affected creditor receives payments and/or property having a present value of at least the amount the claims in the class would have received if all creditors holding claims against the petitioner had been allowed to enforce them on the date the petition was filed and the distributions are maximized under the circumstances. Under the plan, every affected creditor also must receive a note that provides for 50% of the petitioner's positive free cash flow for ten years following the plan effective date. No plan can be confirmed unless at least one class of affected debt votes to accept the plan, but all other classes can have their claims treated as described above regardless of whether they accept the plan. This protects the public corporations from entering into debt repayment plans they cannot afford.

F. Desire for a Single Court

This Act creates the Public Sector Debt Enforcement and Recovery Act Courtroom of the Court

of First Instance, San Juan Part, which will have exclusive competence and jurisdiction over all matters arising under or related to this Act. Accordingly, it is this Legislative Assembly's desire that all disputes arising under or related to this Act (or to any debt that is affected by it), wherever filed, be directed to and resolved by the Court established by this Act (or to the federal court located in the Commonwealth, if applicable) and that courts in States (and federal courts located outside the Commonwealth) decline to adjudicate such disputes in the same manner that this Legislative Assembly would expect Commonwealth courts to abstain from hearing disputes against States and their instrumentalities facing a similar financial crisis.

G. Conclusion

As previously demonstrated, this Legislative Assembly has the power to enact legislation that allows a public corporation to modify the terms of its debt with the consent of supermajority of its affected creditors or through a court supervised proceeding. Certain public corporations are operating under fiscal and financial conditions such that, if emergency action is not taken to prevent their insolvency, they will have to submit themselves to a debt adjustment process, because with their current revenue structures they will be unable to pay their debts as they become due and honor their contractual obligations, while continuing to provide services to the people. This Act provides the necessary regime to establish an orderly process that will allow those public corporations that so require to satisfy their debts and other contractual obligations to the best of their ability, while guaranteeing the

continuity of the governmental functions in providing essential public services.

In light of the foregoing, this Legislative Assembly, relying on the state of fiscal emergency declared in Act 66-2014, confirms that the approval of this Act is of utmost importance to ensure that the public corporations of the Commonwealth satisfy their debts in an orderly fashion so that indispensable services to the people of Puerto Rico may continue uninterrupted.

BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF PUERTO RICO:

Chapter 1: General Provisions

Subchapter I: Title, Purpose, Nomenclature, and Construction

Section 101.—Short Title and Fiscal Emergency.—

(a) This Act shall be known and may be cited as the "Puerto Rico Public Corporation Debt Enforcement and Recovery Act."

(b) Pursuant to Act No. 66-2014, the Legislative Assembly has declared a state of fiscal emergency for the Commonwealth and its instrumentalities.

(c) The Legislative Assembly, in the exercise of its police power, is empowered to adopt measures aimed at protecting the public health, safety and welfare in a structured manner, while addressing the current fiscal situation of the Commonwealth and, in particular, of its public corporations. To that end, the Legislative Assembly may adopt legislation in response to social and economic interests, as well as in emergencies. Section 19 of the Bill of Rights of the Commonwealth Constitution provides that the enumeration of rights

contained in Article II shall not be construed as to restrict "[t]he power of the Legislative Assembly to enact laws for the protection of the life, health and general welfare of the people". Similarly, Section 18 of the Bill of Rights of the Commonwealth Constitution gives this Legislative Assembly authority to enact laws to address grave emergencies that imperil the public health, safety or essential public services."

(d) This Act is adopted in the exercise of the Commonwealth's police power, as well as under the Legislative Assembly's power to adopt laws for the protection of the life, health and welfare of the people, such as in emergencies where the health, public safety and essential government services are clearly endangered. For these reasons, this Act shall prevail over any other law.

(e) The public policy of this Act shall be to restore the credit of the public corporations of the Commonwealth by improving the fiscal condition of the public corporations without affecting the essential functions of such entities.

Section 102.—Definitions.—

The following words and terms, when used and referred to in this Act, shall have the meaning stated below:

(1) "Act" means this Puerto Rico Public Corporation Debt Enforcement and Recovery Act.

(2) "administrative expense" means an expense of a petitioner, incurred or accrued from and after the date its petition is filed up through the date a plan is confirmed in its case, in respect of new value provided or new obligations incurred, including any expenses necessary to fulfill the petitioner's public functions.

(3) "affected creditor" means a creditor holding affected debt.

(4) "affected debt" means the debt scheduled pursuant to section 302(a)(2) of this Act.

(5) "affected debt instrument" means each debt instrument related to an obligation identified in a suspension period notice, provided that no debt instrument evidencing an obligation incurred pursuant to section 206 or section 322 of this Act shall qualify as an affected debt instrument.

(6) "affiliate" means, with respect to an entity, another entity that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the entity first specified.

(7) "approval order" means an order of the Court under chapter 2 of this Act finding that:

(a) the amendments, modifications, waivers, or exchanges, as the case may be, proposed in a consensual debt relief transaction are consistent with the requirements of chapter 2 of this Act, including the objectives stated in section 201(a) of this Act and the requirements of sections 202(d)(1) through 202(d)(3) of this Act; and

(b) the voting procedure followed in connection with the consensual debt relief transaction was carried out in a manner consistent with the requirements of chapter 2 of this Act.

(8) "case" means a case commenced under chapter 3 of this Act.

(9) "cash collateral" means a petitioner's cash and cash equivalents to the extent encumbered by valid liens or security interests.

(10) "claim" means:

(a) a right to present or future payment, whether matured, unmatured, contingent, noncontingent, disputed, undisputed, liquidated, or unliquidated; or

(b) a right to an equitable remedy for which money damages are a remedy under applicable law.

(11) "Commonwealth" means the Commonwealth of Puerto Rico.

(12) "Commonwealth Constitution" means the Constitution of the Commonwealth of Puerto Rico, as amended.

(13) "Commonwealth Entity" means the Commonwealth and a department, agency, district, municipality, or instrumentality (including a public corporation) of the Commonwealth, including any successor entity or additional entity created or to be created to perform any function of such Commonwealth Entity.

(14) "Commonwealth law" means any law of the Commonwealth, or rule or regulation of any Commonwealth Entity.

(15) "consensual debt relief transaction" has the meaning given to that term in section 201(b) of this Act.

(16) "contract" means any contract or agreement, including any debt instrument or unexpired lease, any collective bargaining agreement, any retirement or post-employment benefit plan, and any other agreement or instrument providing for amounts or benefits due by the petitioner to any retiree or employee.

(17) "control," including the terms "controlling," "controlled by," and "under common control with," means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity, whether through the ownership of voting securities, by contract, or otherwise.

(18) "Court" means the Public Sector Debt Enforcement and Recovery Act Courtroom of the Court of First Instance, San Juan Part, described in section 109 of this Act.

(19) "Court of Appeals" means the Court of Appeals of the Commonwealth of Puerto Rico.

(20) "Court of First Instance" means the Court of First Instance of the Commonwealth of Puerto Rico.

(21) "creditor" means a holder of a claim against, either or both:

(a) a public sector obligor seeking a consensual debt relief transaction under chapter 2 of this Act; and

(b) a petitioner under chapter 3 of this Act.

(22) "creditors' committee" means a committee appointed by the Court pursuant to section 318 of this Act.

(23) "critical vendor debt" means special trade debt owed to an entity that agrees to deliver, during the pendency of a case under chapter 3 of this Act and through the effective date, ongoing provision of goods and services to the petitioner—

(a) on the same or better terms for the petitioner than those in place during the one hundred and eighty (180) days preceding the filing of a petition under chapter 3 of this Act; and

(b) that the petitioner has designated as critical to its ability to perform public functions.

(24) "custodian" means:

(a) a receiver or trustee of any of the property of an entity;

(b) an assignee under a general assignment for the benefit of an entity's creditors; or

(c) a trustee, a receiver, a conservator, or an agent under any applicable law, common law right, or under any contract, that is appointed or authorized to take charge of property of an entity for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of some or all of the entity's creditors.

(25) "debt" means liability on a claim.

(26) "debt instrument" includes any document or statement for, used in connection with, or related to:

(a) any obligation to pay the principal of, premium of, if any, interest on, penalties, reimbursement or indemnification amounts, fees, expenses, or other amounts relating to any indebtedness, and any other liability, contingent or otherwise,

(i) for borrowed money,

(ii) evidenced by bonds, debentures, indentures, notes, resolutions, credit agreements, trade finance agreements, trade finance facility agreements, securities, or similar instruments, or

(iii) for any letter of credit or performance bond;

(b) any liability of, or related to, the kind described in the preceding clause (a), which has been guaranteed or insured;

(c) any obligation in respect of bankers' acceptances;

(d) any obligation in respect of a swap agreement, derivative contract or related agreement, hedge agreement, securities contract, forward contract, repurchase agreement, option, warrant, commodities contract, or similar document;

(e) any and all deferrals, renewals, extensions, and refunding of, or amendments, modifications, or supplements to, any liability of the kind described in any of the preceding clauses (a) through (d);

(f) any liability arising out of any judgment relating to any liability of the kind described in any of the preceding clauses (a) through (e); or

(g) any liability arising from an obligation of insurance relating to any liability of a kind described in this section.

(27) "effective date" of a plan has the meaning given to that term in section 315(1) of this Act.

(28) "eligible obligor" means a public sector obligor satisfying the eligibility criteria in section 113(a) of this Act, rendering it eligible to seek relief under chapter 2 of this Act.

(29) "emergency manager" means a natural person appointed as emergency manager pursuant to section 135 of this Act.

(30) "employee claims against a successor employer" means any liability or obligation relating to the petitioner's employees' rights pursuant to any contract or applicable law not expressly assumed in a transfer pursuant to section 307 of this Act.

(31) "entity" includes an individual, a person, an estate, a trust, a Commonwealth Entity, a governmental unit that is not a Commonwealth Entity, a corporation, a partnership, and a limited liability company.

(32) "enumerated entity" means the eligible obligor and the petitioner, as applicable, and each of their successors or assigns to all or part of their business; the Commonwealth; GDB; any governing body of any of the foregoing; any emergency manager; any official of an employee benefit plan to which any of the foregoing in the past contributed or now contributes and any trustee or other official of any pension fund or retirement or post-employment benefit plan for the benefit of any past or present employee of any of the foregoing; the oversight commission appointed pursuant to section 203 of this Act; any member of such oversight commission; any creditors' committee; any member of a creditors' committee or its representative on the creditors' committee; any elected official; any entity appointed by an elected official or any other public official; any professional retained by any of the foregoing; any past or present advisor, agent, consultant, controlling person (if any), director, employee, manager, member, officer, partner, or stockholder of any of the foregoing; and any successor, assign, and personal representative of any of the foregoing.

(33) "essential supplier contract" means a contract, or type of contract, for the provision of goods or services to a public sector obligor seeking relief under this Act, which contract or type of contract is necessary for such public sector obligor to continue performing public functions, and as identified—

(a) with respect to an eligible obligor, on a schedule published on the website on the date the suspension period notice is published; and

(b) with respect to a petitioner, on the schedule specified in section [302(a)(2)] of this Act.

(34) "financially self-sufficient" means, in respect of any public sector obligor, able to meet its projected operating expenses, capital expenditure requirements, working capital requirements, and financing costs out of its projected revenues within the period of time specified in the recovery program without the need for subsequent relief under this Act or financial support from any Commonwealth Entity.

(35) "GDB" means the Government Development Bank for Puerto Rico, including any successor entity or additional entity created or to be created to perform any function of the Government Development Bank for Puerto Rico.

(36) "general committee" means the committee formed pursuant to section 318(a) of this Act.

(37) "governing body" means:

(a) the board of directors of a public corporation; and

(b) any deliberative body by means of which an instrumentality exercises its authority, as

provided in the particular instrumentality's enabling act.

(38) "Governor" means the person serving as the Governor of the Commonwealth pursuant to Article IV of the Commonwealth Constitution.

(39) "insolvent" means:

(a) currently unable to pay valid debts as they mature while continuing to perform public functions; or

(b) will be unable or at serious risk of being unable, without further legislative acts or without financial assistance from the Commonwealth or GDB, to pay valid debts as they mature while continuing to perform public functions

(40) "instrumentality" means an entity created by Commonwealth law as an entity authorized to perform public functions for the Commonwealth.

(41) "noticing agent" means the agent that an eligible obligor, a petitioner, or GDB (acting on behalf of the eligible obligor or petitioner) may retain at the expense of such eligible obligor or petitioner pursuant to section 121 of this Act.

(42) "oversight commission" means a body composed of three (3) independent experts appointed by the Governor under chapter 2 of this Act, not more than one (1) of whom may be a resident of the Commonwealth at the time of appointment.

(43) "party in interest" includes a public sector obligor that seeks relief under chapter 2 of this Act or that files a petition under chapter 3 of this Act, the Governor, GDB, a creditor of such public sector obligor, a creditors' committee, an indenture trustee (or entity

performing comparable functions) acting in the interest of one or more of such public sector obligor's creditors, and a party to a contract scheduled pursuant to section 302(a)(2) of this Act.

(44) "performing public functions" or other similar phrase including "fulfilling public functions" and "serving public functions" means serving an important government purpose—including providing goods or services important or necessary for the protection of public health, safety, or welfare (which include the promotion of the economic activity of the Commonwealth)—whether such public functions are performed directly, or indirectly by facilitating or assisting another Commonwealth Entity to serve such a purpose.

(45) "petition" means the document filed by a petitioner to commence a case under chapter 3 of this Act pursuant to section 301 of this Act.

(46) "petitioner" means a public sector obligor that files a petition—or on whose behalf GDB, upon the Governor's request, files a petition—pursuant to section 301 of this Act.

(47) "plan" means a debt enforcement plan proposed under chapter 3 of this Act.

(48) "pleading" means any document, including any motion, filed with the Court in any proceeding under chapter 2 or chapter 3 of this Act.

(49) "public corporation" means an entity created by Commonwealth law as a public corporation.

(50) "public sector obligor" means a Commonwealth Entity, but excluding:

(a) the Commonwealth;

(b) the seventy-eight (78) municipalities of the Commonwealth; and

(c) the Children's Trust; the Employees Retirement System of the Government of the Commonwealth of Puerto Rico and its Instrumentalities; GDB and its subsidiaries, affiliates, and entities ascribed to GDB; the Judiciary Retirement System; the Municipal Finance Agency; the Municipal Finance Corporation; the Puerto Rico Public Finance Corporation; the Puerto Rico Industrial Development Company, the Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority; the Puerto Rico Infrastructure Financing Authority; the Puerto Rico Sales Tax Financing Corporation (COFINA); the Puerto Rico System of Annuities and Pensions for Teachers; and the University of Puerto Rico.

(51) "recovery program" means, consistent with section 202 of this Act, for an eligible obligor, a financial and operational adjustment program.

(52) "special trade debt" means any claim for the provision of goods or services that

(a) is scheduled pursuant to section 302(a)(2) of this Act, and

(b) exceeds a threshold to be determined by the petitioner in its reasonable discretion, but not to be less than $1 million;

(53) "statement of allocation," "amended statement of allocation," and "final statement of allocation" have the meanings given to those terms in section 308 of this Act.

(54) "Supreme Court" means the Supreme Court of the Commonwealth of Puerto Rico.

(55) "suspension period" means the period of time commencing on the date that the suspension period notice is published, and ending on the earlier of:

(a) the date that the approval order has become a final and unappealable order;

and

(b) the date on which either of the conditions specified in section 205(e) of this Act has occurred.

(56) "suspension period notice" means the notice published pursuant to section 201(d) of this Act.

(57) "transfer order" means the order approving a transfer pursuant to section 307 of this Act.

(58) "United States" means the United States of America.

(59) "U.S. Constitution" means the Constitution of the United States, as amended.

Section 103.—Interpretation.—

(a) The terms of this Act shall be liberally construed in favor of furthering the legislative objectives of this Act.

(b) The singular includes the plural.

(c) Any neuter personal pronoun shall be considered to mean the corresponding masculine or feminine personal pronoun, as the context requires.

(d) The phrase "after notice and a hearing," or other similar phrase means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances, provided, however, an

act may be authorized without a hearing if notice is given properly under the circumstances and if—

(1) a hearing is not timely requested by a party in interest; or

(2) there is insufficient time for a hearing to be commenced before such act must be done, and the Court authorizes such act.

(e) The phrase "at any time" means at any time and from time to time.

(f) A "claim against the petitioner" includes any claim against property of the petitioner.

(g) The words "includes" and "including" are not limiting.

(h) The phrase "may not" is prohibitive, and not discretionary.

(i) The word "or" is not exclusive.

(j) The phrase "applicable law" includes applicable laws, rules, and regulations, including this Act.

(k) A definition contained in a section of this Act that refers to another section of this Act does not, for the purpose of such reference, affect the meaning of a term used in such other section.

(l) The phrase "counterparty" means:

(1) with respect to a collective bargaining agreement, the union that is a bargaining unit under such contract, and not any individual member of such union;

(2) with respect to a pension fund, the administrator of such pension fund, and not any beneficiary of such fund; and

(3) with respect to a retirement or post-employment benefit plan, the administrator of such retirement or post-employment benefit plan, and not any beneficiary of such plan.

(m) The phrase "final and unappealable" shall mean a final and unappealable order, resolution, judgment, or other ruling that is no longer subject to appeal or certiorari proceeding.

(n) The phrase "use or transfer" includes a lease and a sale and lease back transaction.

(o) Any reference to "website" with respect to an eligible obligor or a petitioner means either the website of such eligible obligor or petitioner, or the website specified in section 121 of this Act.

(p) For purposes of interpreting this Act, the Court shall consider to the extent applicable jurisprudence interpreting title 11 of the United States Code.

(q) The phrases "goods" or "services" do not include money loaned or other financial debt incurred.

Section 104.—Applicability of Act.—

This Act is applicable as to all debts—as they exist, prior to, on, and after the effective date of this Act—of any public sector obligor that requests relief under chapter 2 of this Act or that files a petition under chapter 3 of this Act; provided, however, that some of a public sector obligor's debt may remain unaffected by this Act as provided herein.

Section 105.—Evidentiary Standard.—

Unless expressly otherwise provided, the requisite standard of proof in any proceeding under this Act is proof by a preponderance of the evidence.

Section 106.—Savings and Severability Clause.—

This Act shall be interpreted in a manner to render it valid to the extent practicable in accordance with the Commonwealth Constitution and the U.S. Constitution. If any clause, paragraph, subparagraph, article, provision, section, subsection, or part of this Act, were to be declared unconstitutional by a competent court, the order to such effect issued by such court will neither affect nor invalidate the remainder of this Act. The effect of such an order shall be limited to the clause, paragraph, subparagraph, article, provision, section, subsection, or part of this Act declared unconstitutional.

Section 107.—Language Conflict.—

This Act shall be adopted both in English and Spanish. If in the interpretation or application of this Act any conflict arises as between the English and Spanish texts thereof, the English text shall govern. It is recognized that certain terms and phrases used in this Act are terms and phrases used in English in the context of Title 11 of the U.S. Code.

Section 108.—Inapplicability of Other Laws.—

(a) Any other Commonwealth law or any certificate of incorporation, bylaw, or other governing instrument of any Commonwealth Entity is superseded to the extent inconsistent with this Act. Any and all procedural rules herein shall supersede any other conflicting Commonwealth law

to the extent inconsistent with this Act. For the avoidance of doubt, the Commerce Code of 1932, as amended, and Act No. 60 of April 27, 1931, as amended, do not apply to any public sector obligor under this Act.

(b) This Act supersedes and annuls any insolvency or custodian provision included in the enabling or other act of any public corporation, including Section 17 of Act No. 83 of May 2, 1941, as amended, and Section 13 of Act No. 40 of May 1, 1945, as amended.

(c) Any contradiction between the enabling or other act of any public corporation or otherwise applicable Commonwealth law and this Act shall be resolved as if this Act supercedes. For purposes of Section 27 of Act No. 83 of May 21, 1941 and Section 21 of Act No. 74 of June 23, 1965, this Act shall be interpreted as specifically amending such Act No. 83 and Act No. 74, respectively. Nothing contained in the aforementioned Act No. 83, as amended, nor in the enabling legislation of any other Commonwealth Entity shall be construed as limiting in any way the application of the provisions of this Act.

Subchapter II: Jurisdiction and Procedure

Section 109.—The Court.—

(a) The Public Sector Debt Enforcement and Recovery Act Courteoom is created herein, which shall be located in and be part of the Court of First Instance, San Juan Part. The Chief Justice of the Supreme Court may designate a judge of the Puerto Rico judicial system.

(b) A judge appointed pursuant to subsection (a) of this section may appoint a special commissioner in accordance with Rule 41 of the Puerto Rico Rules of Civil Procedure. The special commissioner must be a person of recognized expertise in financial matters, including insolvency proceedings. The special commissioner is empowered to oversee multiple proceedings under either or both chapter 2 and chapter 3 of this Act, either simultaneously or sequentially.

(c) An eligible obligor or a petitioner, as applicable, shall reimburse the appropriate entity within the Judiciary Branch for the costs of administering any proceeding under this Act, including the reasonable and documented costs and expenses of the special commissioner, if any, and, if multiple eligible obligors and/or petitioners exist, the incremental costs shall be allocated among them.

Section 110.—Responsibilities and Powers of the Court.—

(a) In keeping with the prescribed time periods in other sections of this Act, the Court shall endeavor to conduct any proceeding under chapter 2 of this Act or to resolve a case under chapter 3 of this Act with all deliberate speed and efficiency consistent with due process, and taking into account that continuing uncertainty about the resolution of the proceeding is harmful to creditors, to the viability of the public sector obligor, to the credit of the Commonwealth Entities, and to the well-being of the residents and businesses in the Commonwealth.

(b) The Court may issue any order and conduct any processes necessary or appropriate to carry out the provisions of this Act. No provision of chapter 2 or chapter 3 of this Act providing for the raising of an issue by a party in interest shall be construed to preclude the Court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement Court orders or rules, or to prevent an abuse of process.

(c) Notwithstanding any other Commonwealth law, or any contract that is binding on any Commonwealth Entity or to which any of its property is subject, no court established by the Commonwealth shall appoint a custodian with respect to the public sector obligor during the suspension period under chapter 2 of this Act or in or during its case under chapter 3 of this Act under any applicable law or contract.

Section 111.—Subject Matter, Personal, and In Rem Jurisdiction.—

(a) Unless otherwise provided for in this Act, the Court shall have original jurisdiction and exclusive jurisdiction, except in relation to a federal court exercising federal jurisdiction, to consider and adjudicate all disputes arising out of or related to this Act, including the following—

(1) all disputes arising out of or related to affected debt instruments during the suspension period;

(2) all disputes, whether prior to or after entry of an approval order, arising under or related to chapter 2 of this Act, arising in any

proceeding under chapter 2 of this Act, or related to a consensual debt relief transaction proposed under chapter 2 of this Act, including any dispute as to who votes or consents under this Act;

(3) all disputes arising under chapter 3 of this Act or arising in or related to a case under or related to chapter 3 of this Act, including those related to affected debt; and

(4) all proceedings or matters related to the preceding clauses (1) through (3), including proceedings to interpret or enforce an approval order, a confirmed plan, a transfer order, a final statement of allocation, or any part of this Act.

(b) The Court shall have personal jurisdiction over all entities to the fullest extent permitted by the Commonwealth Constitution and the U.S. Constitution. The Court shall have in rem jurisdiction over the property of each public sector obligor.

(c) The Court shall retain subject matter and in rem jurisdiction to interpret and enforce:

(1) a consensual debt relief transaction as to which it has entered an approval order under chapter 2 of this Act; and

(2) a transfer order, a final statement of allocation, and a plan confirmed under chapter 3 of this Act.

Section 112.—Interaction of Chapter 2 and Chapter 3.—

A public sector obligor with the approval of GDB (or, upon the Governor's request, GDB on the public

sector obligor's behalf) may seek relief under either chapter 2 or chapter 3 of this Act, or both simultaneously or sequentially, subject to section 113 of this Act, and may withdraw, in its discretion, a suspension period notice or any obligation identified in a suspension period notice, a proposal for a consensual debt relief transaction, or an application for entry of an approval order under chapter 2 of this Act, prior to entry of an approval order that has become a final and unappealable order. The petitioner, with the approval of GDB (or, upon the Governor's request, GDB on the petitioner's behalf), may withdraw a petition under chapter 3 of this Act.

Section 113.—Eligibility.—

(a) A public sector obligor is eligible for chapter 2 of this Act, if it is authorized to commence a consensual debt relief transaction pursuant to section 201(b)(1) or 201(b)(2) of this Act.

(b) A petitioner is eligible for chapter 3 of this Act, if it—

(1) is insolvent;

(2) is authorized to file a petition under chapter 3 of this Act by its governing body and GDB, or a petition is filed on its behalf by GDB, upon the Governor's request; and

(3) is ineligible for relief under title 11 of the United States Code, because, among other reasons:

(A) it is not a "municipality" having permission of a "state" to file a chapter 9 petition, each as defined in title 11 of the United States Code; and

(B) it is a "governmental unit," as defined in title 11 of the United States Code, that may not seek relief under chapter 11 of title 11 of the United States Code.

Section 114.—Binding Nature of Court Determinations.—

Any determination of the Court shall be binding on the eligible obligor or the petitioner, any entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments or affected debt of such eligible obligor or such petitioner, any trustee, any collateral agent, any indenture trustee, any fiscal agent, any bank that receives or holds funds from such eligible obligor or such petitioner related to the affected debt instruments or affected debt, and any other entity specifically identified in such determination by the Court or the order memorializing such determination.

Section 115.—Effect of Approval, Transfer, and Confirmation Orders.—

(a) An approval order in respect of a consensual debt relief transaction under chapter 2 of this Act and a confirmation order in respect of a plan or transfer order or final statement of allocation under chapter 3 of this Act shall each be treated as a judgment for the purposes of Commonwealth law, subject only to appeal as provided in section 127 of this Act.

(b) Upon entry of an approval order in respect of a consensual debt relief transaction under chapter 2 of this Act—

(1) the amendments, modifications, waivers, or exchanges contained therein

automatically shall take effect and shall be binding on the eligible obligor that is party to the affected debt instrument, any entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments of such eligible obligor, any trustee, any collateral agent, any indenture trustee, any fiscal agent, and any bank that receives or holds funds from such eligible obligor related to the affected debt instruments; and

(2) the Court shall retain jurisdiction, and thereafter no entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments of such eligible obligor, no trustee, no collateral agent, no identure trustee, no fiscal agent, and no bank that receives or holds funds from such eligible obligor related to the affected debt instruments shall bring any action or proceeding of any kind or character for the enforcement of such claim or remedies in respect of such affected debt instruments, except with the permission of the Court and then only to recover and enforce the rights permitted under the amendments, modifications, waivers, or exchanges, and the approval order.

(c) Except as otherwise provided in a plan, in the order confirming such plan, in a transfer order, or in a final statement of allocation, each under chapter 3 of this Act, upon entry of a confirmation order, a transfer order, or a final statement of allocation:

(1) the provisions of the confirmed plan and order confirming such plan bind the petitioner

and all creditors whose rights are affected by the plan;

(2) the transfer order and final statement of allocation bind the petitioner and all creditors whose rights are affected by such transfer order or final statement of allocation; and

(3) all creditors affected by the plan or the final statement of allocation shall be enjoined from, directly or indirectly, taking any action inconsistent with the purpose of this Act, including bringing any action or proceeding of any kind or character for the enforcement of such claim or remedies in respect of affected debt, except as each has been affected pursuant to the plan under chapter 3 of this Act or the final statement of allocation.

(d) Except as expressly otherwise provided in an approval order under chapter 2 of this Act, or a plan, an order confirming a plan, a transfer order, or a final statement of allocation under chapter 3 of this Act, upon entry of any such order or final statement of allocation, the eligible obligor or the petitioner is authorized to perform all acts set forth in the debt relief transaction, the approval order, the plan, the order confirming such plan, the transfer order, or the final statement of allocation, without any further authorization from any Commonwealth Entity or the Court.

(e) The Court may direct the eligible obligor, the petitioner, and any other necessary party to execute, to deliver, or to join in the execution or delivery of any contract required to effect a transfer of property dealt with by an approved consensual debt relief transaction under chapter 2 of this Act,

or a final statement of allocation or a confirmed plan under chapter 3 of this Act, and to perform any other act, including the satisfaction of any lien, that is necessary for the consummation of the consensual debt relief transaction, the final statement of allocation, or the plan.

Section 116.—Service of Process.—

Except as otherwise ordered by the Court, service of process may be made by any of the means described in subsections (a), (b), or (c) below:

(a) Subject to section 337 of this Act, service of process may be made by the entities and in the manner prescribed by Rules 4.3 and 4.4 of the Puerto Rico Rules of Civil Procedure, or by notice by mail to the last known address of the individual or entity to be served.

(b) Notice by mail or direct transmission may be made in accordance with sections 204(c)(2) and 338 of this Act or as the Court otherwise orders.

(c) Notice by Publication.

(1) The Court may order notice by publication if it finds that notice by mail is impracticable or that it is desirable to supplement the notice by mail.

(2) Pursuant to Rule 4.6 of the Puerto Rico Rules of Civil Procedure, or as further detailed below, notice by publication, published at least three (3) times at least fourteen (14) days prior to a specified hearing, in both a newspaper of national circulation in the United States, and a newspaper of general circulation in the Commonwealth, shall be required to supplement notice of:

(A) the approval hearing pursuant to section 204(b) of this Act with regard to a consensual debt relief transaction under chapter 2 of this Act;

(B) the eligibility hearing pursuant to section 306 of this Act;

(C) the hearing on a transfer of all or substantially all assets of the petitioner pursuant to section 307 of this Act; and

(D) the confirmation hearing pursuant to section 314 of this Act.

(3) Notice by publication, published at least three (3) times during the fourteen (14) days after each event specified in subsections (c)(3)(A) and (c)(3)(B) of this section, in both a newspaper of national circulation in the United States, and a newspaper of general circulation in the Commonwealth, shall be required to supplement notice of:

(A) the filing of an application pursuant to section 204(a) of this Act; and

(B) the filing of a petition pursuant to section 301 of this Act.

Section 117.—Application of the Puerto Rico Rules of Civil Procedure.—

To the extent not inconsistent with this Act, the Puerto Rico Rules of Civil Procedure shall apply to any proceedings under chapter 2 and chapter 3 of this Act.

Section 118.—Language.—

(a) All pleadings, requests, and motions under this Act shall be filed in accordance with Rule 8.7 of the Puerto Rico Rules of Civil Procedure;

provided, however, that all pleadings, requests, and motions filed in Spanish shall be accompanied by an English translation.

(b) All hearings, opinions, and orders shall be in the language designated by the presiding judge and in accordance with Act No. 1 of January 28, 1993.

(c) Each public sector obligor seeking relief under this Act shall post on its website copies in Spanish and English of each consensual debt transaction proposed under chapter 2 of this Act and each plan proposed in a case under chapter 3 of this Act.

Section 119.—Notice of Appearance and Pleading Requirements.

(a) To the extent applicable under this Act, any party in interest may file a notice of appearance with the Court requesting all notices and pleadings be transmitted to such party or its attorney at the email addresses specified in its notice of appearance, or, if an email address is not available, at the mailing address specified in its notice of appearance.

(b) Every pleading filed in a proceeding or case under this Act shall include the mailing address and email address, if available, of the entity or entities on behalf of which the pleading is filed.

(c) Any entity filing a pleading, inclusive of a notice of appearance, with the Court shall email an identical copy of the document filed to the noticing agent, eligible obligor, or petitioner maintaining the website contemporaneously with filing the

document with the Court or sending it to the Court for filing. Any entity not having the ability to send such a document by email shall mail it by certified mail to the noticing agent, eligible obligor, or petitioner maintaining the website contemporaneously with filing it with the Court or mailing it to the Court for filing.

(d) Each eligible obligor and petitioner shall include on each of its pleadings in bold, 12-point font the following statement: "Every entity filing a document with the Court under the Puerto Rico Public Corporation Debt Enforcement and Recovery Act shall email an identical copy of the document filed to the entity maintaining the website required by section 121 hereof to the following email address [insert email address here], or if unable to transmit emails shall mail the copy to the following address [insert mailing address here].

(e) All petititions and documents filed under this Act shall be filed electronically. An electronic judicial file shall be kept for corresponding cases pursuant to the provisions of Rule 67.6 of the Rules of Civil Procedure and Act 148-2013."

Section 120.—Objections.—

Whenever an entity objects to or challenges the relief requested under chapter 2 or chapter 3 of this Act, such entity shall provide, within five (5) business days of an eligible obligor's or a petitioner's written request, all documents in its possession, custody, or control supporting, and all documents in its possession, custody, or control opposing, the objecting party's claim and objection. This production shall be in addition to responses to any additional valid discovery requested

by the eligible obligor or petitioner. Any such objection shall—

(a) be in writing and filed with the Court, no later than seven (7) business days prior to the relevant hearing unless the Court orders otherwise or as otherwise specified in this Act;

(b) articulate clearly the basis for the objection; and

(c) be accompanied by a statement, sworn under oath, that includes—

(1) the name of each objecting entity that holds or controls the beneficial interest in an affected debt instrument of the eligible obligor seeking relief under chapter 2 of this Act or an affected debt of a petitioner in a case under chapter 3 of this Act;

(2) a description of the beneficial interest that is held or controlled by such objecting entity or any of its controlled affiliates (naming such affiliates) in any of the following:

(A) the affected debt instrument or any affected debt, including the amount of any claim;

(B) any interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting any of the foregoing entities or affiliates an economic interest that is affected by the value, acquisition, or disposition of the affected debt instrument or affected debt; and

(C) any credit default swap of any insurance company that insures any obligation of any Commonwealth Entity;

(3) a statement whether each interest disclosed pursuant to sections 120(c)(2)(A) through 120(c)(2)(C) of this Act was acquired before or after the commencement of the suspension period under chapter 2 of this Act or before or after the date the petition was filed under chapter 3 of this Act; and

(4) a statement whether each interest disclosed pursuant to sections 120(c)(2)(A) through 120(c)(2)(C) of this Act may appreciate in value if any debt issued by any Commonwealth Entity declines in value.

Section 121.—Noticing Agent.—

(a) Each the eligible obligor, the petitioner, or GDB (acting on behalf of the eligible obligor or the petitioner), shall carry out the disclosure mechanisms and noticing requirements provided in this section, and, to that end, may retain and employ an entity to serve as noticing agent to:

(1) create and maintain a website, accessible free of charge, containing all pleadings, orders, opinions, and notices properly filed under chapter 2 or chapter 3 of this Act, and a calendar showing all deadlines and hearings; and

(2) provide notices of all hearings and deadlines, and perform related functions, including those of a claims agent where applicable.

(b) The noticing agent shall maintain on the website a list of all parties in interest who file notices of appearance pursuant to section 119 of this Act, together with the email addresses or mailing addresses to which each party in interest requested that notices and pleadings be sent.

(c) The noticing agent shall be compensated at rates based on its normal charges for such services to other debtors in collective proceedings to enforce claims, such as cases under chapter 9 or chapter 11 of title 11 of the United States Code.

Section 122.—Confidentiality of Certain Filings.—

(a) The Court, for cause, may protect an individual with respect to the following types of information to the extent the Court finds that disclosure of such information would create undue risk of identity theft or other unlawful injury to the individual or the individual's property:

(1) any means of identification (as defined in 18 U.S.C. § 1028(d)) contained in a paper filed, or to be filed, in a proceeding or case under this Act; and

(2) other information contained in a paper described in subsection (a)(1) of this section.

(b) Upon ex parte or noticed application demonstrating cause, the Court shall provide access to information protected pursuant to subsection (a) of this section to an entity acting pursuant to the police or regulatory power of a Commonwealth Entity.

Section 123.—Confidential Deliberations.—

Notwithstanding any otherwise applicable Commonwealth law, including Act No. 159-2013, as amended, all deliberations regarding whether to seek relief under this Act, what plan or relief to propose, or other matters relating to this Act, shall not be made public, but adequate records of such deliberations shall be maintained. Such deliberations shall be privileged under Commonwealth law and shall neither be subject to discovery in any civil proceeding nor subject to disclosure, except as required by Commonwealth law or applicable U.S. law in connection with raising money or otherwise selling or buying securities.

Section 124.—No Implied Private Right of Action.—

There is no implied private right of action under this Act.

Section 125.—Special Counsel, Professional Disclosure, and Retainers.—

(a) To the extent, if any, that two public sector obligors seeking relief under this Act and represented by the same legal professionals have one or more disputes between such public sector obligors, or a public sector obligor seeking relief under this Act and GDB represented by the same legal counsel have one or more disputes between them, in each case, the disputes shall be handled by special counsel for each of the parties to the dispute.

(b) Each professional firm retained, respectively, by or for the public sector obligor(s) seeking relief under this Act or by one or more creditors' committees shall file with the Court no

later than fourteen (14) days after its retention a written disclosure of its then current representation of entities in related or unrelated matters, which entities, to the best of the professional's actual knowledge, are (1) a Commonwealth Entity or (2) based on a reasonable review of the books and records of the eligible obligor or petitioner, hold claims against or other economic interests in respect of such eligible obligor or petitioner. Each professional shall promptly update its disclosures contemplated by this subsection (b) as it obtains additional information or as facts change.

(c) Notwithstanding any other Commonwealth law, a retainer may be advanced to any financial and legal advisors of the eligible obligor, the petitioner, and GDB.

(d) In the event that the rules regarding conflicts of interests set forth in Canon 21 of the Canons of Professional Ethics and its interpretative jurisprudence make it impractical for a public sector obligor to obtain legal representation of the highest level of competency to represent such public sector obligor in a proceeding under chapter 2 or chapter 3 of this Act involving more than one hundred (100) creditors (including beneficial owners of publicly traded debt) that does not have a conflict or potential conflict, such public sector obligor may file a petition with the Supreme Court for a waiver of the rules regarding conflicts of interests set forth in Canon 21 of the Canons of Professional Ethics or for the approval of a special rule, setting forth the reasons supporting the request. In considering the merits of any such petition, the Supreme Court may take into

consideration the special rules and accompanying jurisprudence regarding conflicts of interest set forth in section 327 of title 11 of the United States Code and Rule 2014 of the Federal Rules of Bankruptcy Procedure, including, but not limited to, those permitting the designation of one or more conflict counsel who would represent the public sector obligor in those matters that could represent a conflict for the attorneys representing the public sector obligor in a proceeding under chapter 2 or chapter 3 of this Act.

Section 126.—Bond Requirement.—

In the discretion of the Court or the Supreme Court, any entity may be ordered to post a bond in the amount determined by the Court or the Supreme Court when—

(a) seeking to enjoin compliance with or proceedings pursuant to all or a portion of this Act; or

(b) appealing from a decision of the Court and requesting a stay of such decision under this Act.

Section 127.—Appeals.—

(a) Any appeal of an approval order, a transfer order, a final statement of allocation, or a confirmation order shall be filed with the Supreme Court no later than fourteen (14) days after the filing in the record of a copy of the notice of the approval order, the transfer order, the final statement of allocation, or the confirmation order, respectively.

(b) All other appeals shall be taken as provided by the law of the Commonwealth, and

subject to subsection (a) of this section, nothing in this Act shall limit an appellate court's review of matters decided by the Court.

Subchapter III: Creditors' Protections and Governance

Section 128.—Compliance with Commonwealth Constitution and U.S. Constitution.—

If a party to a contract with an eligible obligor or a petitioner demonstrates that its treatment under this Act substantially or severely impairs its rights under such contract for purposes of the Commonwealth Constitution or the U.S. Constitution without providing an adequate remedy therefor, the substantial or severe impairment shall be allowed only if the eligible obligor, the petitioner, or GDB, each as applicable, carries the burdens imposed on it by the Commonwealth Constitution and the U.S. Constitution with respect to demonstrating its use of reasonable and necessary means to advance a legitimate government interest, and the aggrieved entity fails to carry the burden of persuasion to the contrary.

Section 129.—Adequate Protection and Police Power.—

(a) When an entity's interest in property is entitled to adequate protection under this Act, it may be provided by any reasonable means, including—

(1) cash payment or periodic cash payments;

(2) a replacement lien or liens (on future revenues or otherwise); or

(3) in connection with a case under chapter 3, administrative claims, in each case, solely to the extent that the suspension period, the automatic stay, the use or transfer of property subject to a lien, or the granting of a lien under this Act results in a decrease in value of such entity's interest in property subject to the lien as of commencement of the suspension period or a chapter 3 case.

(b) Without limiting subsection (a) of this section, adequate protection of an entity's interest in cash collateral, including revenues, of the eligible obligor or the petitioner, as applicable, may take the form of a pledge to such entity of future revenues (net of any current expenses, operational expenses or other expenses incurred by the eligible obligor or the petitioner under this Act) of such eligible obligor or petitioner if—

(1) the then-current enforcement of such entity's interest would substantially impair the ability of such eligible obligor or petitioner to perform its public functions;

(2) there is no practicable alternative available to fulfill such public functions in light of the circumstances; and

(3) the generation of future net revenues to repay such entity's secured claims is dependent on the then-current continued performance of such public functions and the future net revenues will be enhanced by the then-current use of cash collateral or revenues to avoid then-current impairment of public functions.

(c) Without limiting subsections (a) and (b) of this section, an eligible obligor or petitioner may recover from or use property securing an interest of an entity the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to such entity, including payment of expenses incurred by such eligible obligor or petitioner pursuant to or in furtherance of this Act.

(d) Notwithstanding any section of this Act conditioning the eligible obligor's or the petitioner's use or transfer of its property on adequate protection of an entity's interest in the property, if and when the police power justifies and authorizes the temporary or permanent use or transfer of property without adequate protection, the Court may approve such use or transfer without adequate protection.

Section 130.—Reserved.—

Section 131.—Limitations on Avoidance Actions.—

No preference action by or on behalf of creditors of any eligible obligor or petitioner shall be prosecuted. No fraudulent transfer action by or on behalf of creditors of any eligible obligor or petitioner shall be prosecuted except such actions for a transfer, or an incurrence of an obligation, that was made with actual intent to hinder, delay, or defraud creditors. Any and all such actions shall be controlled and prosecuted solely by the Commonwealth, in the discretion of its Attorney General, for the benefit of the creditors entitled to bring the action outside of this Act.

Section 132.—Recovery on Avoidance Actions.—

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided pursuant to section 131 of this Act, an eligible obligor or petitioner may recover the property transferred, or, if the Court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) An eligible obligor or petitioner may not recover pursuant to subsection (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) A good faith transferee from whom an eligible obligor or petitioner may recover pursuant to subsection (a) of this section has a lien on the property recovered to secure the lesser of—

(1) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by or accruing to such transferee from such property; and

(2) any increase in the value of such property as a result of such improvement of the property transferred.

(d) The eligible obligor or petitioner is entitled to only a single satisfaction pursuant to subsection (a) of this section.

(e) In this section, the term "improvement" includes—

(1) physical additions or changes to the property transferred;

(2) repairs to such property;

(3) payment of any tax on such property;

(4) payment of any debt secured by a lien on such property that is superior or equal to the rights of the eligible obligor or petitioner; and

(5) preservation of such property.

Section 133.—Right of GDB to Coordinate and Control Debt Enforcement and Recovery Procedures.—

(a) GDB shall have, on its own behalf and on behalf of the public sector obligor, at all stages of proceedings including appeals and certiorari proceedings, standing to raise, appear on, be heard on, prosecute, and defend against any and all issues and requests for relief in a consensual debt relief transaction under chapter 2 of this Act or in a case under chapter 3 of this Act. The eligible obligor or the petitioner shall reimburse GDB for all its costs and expenses therefor.

(b) All rights of a public sector obligor to take action in seeking and leading its consensual debt relief transaction under chapter 2 of this Act or in

commencing and prosecuting its case under chapter 3 of this Act shall extend to GDB on behalf of the public sector obligor, in which instances GDB may act through its own attorneys, or the public sector obligor's attorneys shall take instructions from GDB. Each action taken by GDB shall be binding on the public sector obligor.

Section 134.—GDB Reimbursement.—

(a) The eligible obligor or the petitioner, as applicable, shall reimburse or pay GDB, in full, for GDB's costs and expenses for amounts paid or agreed to be paid, in preparation for seeking relief under this Act, including for the payment of financial and legal advisors of the eligible obligor, the petitioner, and GDB (including any retainer advanced to such advisors), before the commencement of a suspension period under chapter 2 of this Act or of a case under chapter 3 of this Act, or in connection with this Act.

(b) In addition to its reimbursement obligations set forth in subsection (a) of this section, the eligible obligor or the petitioner, as applicable, shall reimburse GDB, in full, for GDB's—

(1) costs and expenses (including payments to financial and legal advisors) for services provided by GDB to the eligible obligor or the petitioner, each before and after the commencement of the suspension period under chapter 2 of this Act or of a case under chapter 3 of this Act, or in connection with the prosecution of the rights of the eligible obligor or petitioner under this Act when GDB has acted through its own attorneys pursuant to section 133(b) of this Act; and

(2) outlays incurred each before and after the commencement of the suspension period under chapter 2 of this Act or the filing of a petition under chapter 3 of this Act, in each case, on behalf of the eligible obligor or petitioner for the provision of goods and services paid by GDB and delivered to the eligible obligor or petitioner, and any funds GDB may have provided or provides to the eligible obligor or petitioner, as applicable, that GDB believes are necessary to the performance by the eligible obligor or petitioner of its public functions.

(c) Notwithstanding any other provision of this Act, the eligible obligor or the petitioner, as applicable, shall reimburse or pay GDB, in full, pursuant to subsections (a) and (b) of this section promptly, but no later than ten (10) business days after GDB's written request. Amounts owing to GDB as described in this section may not be adjusted as an affected debt instrument under chapter 2 of this Act or be affected debt under chapter 3 of this Act and shall be formalized and incurred in accordance with laws regulating government contracting, except as provided in this Act. The provisions of Act 66-2014 shall not be applicable to contracts related to services provided in connection with this Act.

Section 135.—Appointment of Emergency Manager.—

The Governor may, at any time during the suspension period under chapter 2 of this Act or during the pendency of a case under chapter 3 of this Act, appoint an emergency manager for the eligible obligor or petitioner, as applicable. The Governor may choose

any individual to serve as emergency manager, including, without limitation, a current or former officer of the eligible obligor or petitioner. The Governor may empower the emergency manager to oversee multiple eligible obligors or petitioners simultaneously or sequentially. The emergency manager shall subject to the applicable provisions and obligations entered into pursuant to Act 66-2014:

(a) exclusively possess and exercise all powers of the governing body and the principal executive officer of the eligible obligor or petitioner, as applicable, and the powers of the existing governing body of the eligible obligor or petitioner shall be suspended during the emergency manager's tenure;

(b) report periodically to such governing body regarding the operations of the eligible obligor or petitioner, as applicable, the progress of the restructuring process under chapter 2 of this Act or prosecution of the petitioner's plan under chapter 3 of this Act, and the governing body may provide advice to the emergency manager;

(c) report to the Governor, the Legislative Assembly and GDB upon request;

(d) serve:

(1) during the suspension period and may continue serving for a period of up to three (3) months after entry of the approval order, which period may be extended for three (3) additional months by the Governor or as otherwise provided for in the recovery program;

(2) during the chapter 3 case, unless and until replaced by the Governor, and shall

continue serving for a period of three (3) months after the effective date of the plan, which period may be extended for three (3) additional months by the Governor; or

(3) until the Governor, in his absolute discretion, determines; provided, however, that the periods set forth in items (d)(1) and (d)(2) above shall not be exceeded; and

(e) be compensated by the eligible obligor or petitioner, as applicable, according to terms of employment approved by the Governor with advice of GDB.

Section 136.—Ongoing Operations.—

(a) During the suspension period under chapter 2 of this Act or the pendency of a case under chapter 3 of this Act, an eligible obligor or petitioner, as applicable, shall (i) operate the enterprise and make all personnel and other business determinations during the suspension period or the pendency of a case under chapter 3 of this Act, in each case in accordance with applicable law, (ii) remain in possession and control of its assets and, (iii) subject to sections 307 and 323 of this Act, shall be authorized to use and transfer such assets without Court approval.

(b) The Governor may at any time, on an interim basis during the suspension period or during the pendency of a case under chapter 3 of this Act, appoint new members of the governing body of any eligible obligor or petitioner, as applicable, with the advice and consent of the Senate, to substitute for some or all of those

existing members of the governing body who had been appointed by the Governor.

(c) The Governor may exercise either, both, or neither of the powers granted by subsection (b) of this section and section 135 of this Act, sequentially or simultaneously, as the case may be.

Section 137.—Quasi-immunity of the Eligible Obligor and the Petitioner, Creditors' Committee Personnel, and Government Officials.—

(a) Except to the extent proven by final and unappealable judgment, to have engaged in willful misconduct for personal gain or gross negligence comprising reckless disregard of and failure to perform applicable duties, the enumerated entities shall not have any liability to any entity for, and without further notice or order shall be exonerated from, actions taken or not taken in their capacity, and within their authority in connection with, related to, or arising under, or as permitted under this Act.

(b) No action shall be brought against any enumerated entity concerning its acts or omissions in connection with, related to, or arising under this Act, except in the Court. No civil cause of action may arise against and no civil liability may be imposed on such enumerated entities absent clear and convincing proof of willful misconduct for personal gain or gross negligence comprising reckless disregard of and failure to perform applicable duties. Any action brought for gross negligence shall be dismissed with prejudice if a defendant, as an officer, director, official, committee member, professional, or other enumerated entity, produces documents showing such defendant was

advised of relevant facts, participated in person or by phone, and deliberated in good faith or received and relied on the advice of experts in respect of whatever acts or omissions form the basis of the complaint.

Chapter 2: Consensual Debt Relief

Section 201.—Consensual Debt Relief Transactions.—

(a) The objectives of chapter 2 of this Act are the following:

(1) to enable an eligible obligor to become financially self-sufficient;

(2) to allocate equitably among all stakeholders the burdens of the recovery program; and

(3) to provide the same treatment to all creditors within a class of affected debt instruments unless a creditor agrees to a less favorable treatment.

(b) An eligible obligor may seek debt relief from its creditors pursuant to one or more transactions in accordance with chapter 2 of this Act (each a "consensual debt relief transaction") if so authorized by either—

(1) its governing body, with the approval of GDB; or

(2) GDB, at the Governor's request, and on behalf of the eligible obligor, if the eligible obligor has not authorized such action and the Governor, with the advice of GDB, determines that it is in the best interest of the eligible obligor and the Commonwealth.

(c) To enable GDB to coordinate the relief requested in instances where the Governor and GDB authorize the consensual debt relief transaction, GDB shall be entitled to select and retain on behalf of the eligible obligor and at the eligible obligor's expense, such professionals as GDB believes are necessary to seek relief under chapter 2 of this Act.

(d) After the eligible obligor obtains authorization pursuant to subsection (b) of this section, the eligible obligor shall publish on its website a notice that—

(1) the suspension period has commenced on the date of such notice; and

(2) identifies which obligations are subject to the suspension period.

(e) The suspension period notice may be amended to add or eliminate obligations, but the suspension period shall commence only from the time the suspension period notice is first published pursuant to subsection (d) of this section.

Section 202.—Relief and Commitment.—

(a) In a consensual debt relief transaction undertaken pursuant to section 201 of this Act, an eligible obligor may seek approval of any amendment, modification, waiver, or exchange to or of the affected debt instruments from the holders of such instruments.

(b) In connection with a consensual debt relief transaction, an eligible obligor must prepare and commit itself by an act of its governing body (if authorized by it, pursuant to section 201(b)(1) of this Act) or by GDB, upon the Governor's request (if

authorized by it pursuant to section 201(b)(2) of this Act) on behalf of the eligible obligor to a recovery program that—

(1) allows the eligible obligor to become financially self-sufficient based on such financial and operational adjustments as may be necessary or appropriate to allocate the burdens of such consensual debt relief equitably among all stakeholders; and

(2) GDB has approved in writing.

(c) The recovery program may include interim milestones, performance targets, and other measures to—

(1) improve operating margins;

(2) increase operating revenues;

(3) reduce operating expenses;

(4) transfer or otherwise dispose of or transfer existing operating assets;

(5) acquire new operating assets; and

(6) close down or restructure existing operations or functions.

(d) In respect of any consensual debt relief transaction, and notwithstanding anything to the contrary contained in an affected debt instrument or otherwise applicable law, the amendments, modifications, waivers, or exchanges proposed in such transaction shall become effective and binding for each affected debt instrument on any entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments, any trustee, any collateral agent, any indenture trustee, any fiscal agent, and any bank

that receives or holds funds from such eligible obligor related to the affected debt instruments, within a class specified in the consensual debt relief transaction, if—

(1) GDB has approved the consensual debt relief transaction in writing;

(2) creditors of at least—

(A) fifty percent (50%) of the amount of debt of such class participates in a vote or consent solicitation with respect to such amendments, modifications, waivers, or exchanges; and

(B) seventy-five percent (75%) of the amount of debt that participates or votes in such class approves the proposed amendments, modifications, waivers, or exchanges;

(3) each class contains claims that are substantially similar to other claims in such class, provided that the term "substantially similar" does not require classification based on similar maturity dates; and

(4) the Court enters an approval order in respect of such consensual debt relief transaction pursuant to section 204 of this Act.

(e) For purposes of calculating the voting percentage set forth in this section, any affected debt instruments held or controlled by any Commonwealth Entity, shall not be counted in such vote.

Section 203.—Oversight Commission.—

(a) An oversight commission shall be established for each eligible obligor that is subject to a recovery program no later than ten (10) days after entry of the approval order. The identity and affiliation(s) of the persons who will serve on the oversight commission shall be disclosed publicly prior to the commencement of the approval hearing. Such oversight commission shall be responsible for monitoring compliance with the recovery program. The eligible obligor subject to the recovery program shall provide the oversight commission with regular updates, not less frequently than once every four (4) months, of its compliance with terms of the recovery program.

(b) If the oversight commission, by majority vote, finds that an eligible obligor has failed to meet an interim performance target or other milestone contained in the recovery program and such failure has continued for at least ninety (90) days thereafter, the oversight commission shall issue a non-compliance finding to the eligible obligor, the Governor and to the Legislative Assembly, with a copy to be made available publicly, explaining the reasons for such non-compliance and making recommendations for curing such non-compliance. Such recommendations may include the replacement of some or all of the management or the governing body of the eligible obligor.

Section 204.—Court Approval of Consensual Debt Relief Transactions.—

(a) Any eligible obligor seeking entry of an approval order shall file an application with the Court requesting such approval not later than

thirty (30) days after obtaining the requisite consent of holders of an affected debt instrument set forth in section 202(d)(2).

(b) The Court shall conduct a hearing to consider entry of the approval order not later than twenty-one (21) days after the filing of the application.

(c) Notwithstanding any contractual provision or applicable law to the contrary, notice of the hearing described in section 204(b) shall be proper and reasonable if—

(1) publication notice of such hearing is made in accordance with section 116(c)(2) of this Act; and

(2) notice of such hearing is transmitted to the holders of the affected debt instruments at least fourteen (14) days prior to such hearing, including through The Depository Trust Company or similar depository, or as the Court otherwise orders.

(d) Subject to the terms and conditions of the affected debt instrument (including any limitations on suits prescribed therein), any holder of an affected debt instrument may object to the relief sought in subsection (a) of this section by filing an objection in accordance with section 120 of this Act, provided, however, that no entity may object if it is not adversely impacted by the actions taken in connection with this Act.

(e) In determining whether an approval order shall be entered, the Court shall consider only whether the amendments, modifications, waivers, or exchanges, as the case may be, proposed in such

transaction, are consistent with the requirements of chapter 2 of this Act and the objectives set forth in section 201(a) of this Act, and whether the voting procedure followed in connection with the consensual debt relief transaction, which shall include a reasonable notice and period of time to vote or consent as the circumstances require, was carried out in a manner consistent with chapter 2 of this Act. If the Court determines that each of these requirements has been satisfied, it shall enter the approval order.

Section 205. —Suspension of Remedies.—

(a) Notwithstanding any contractual provision or applicable law to the contrary, during the suspension period, no entity asserting claims or other rights, including a beneficial interest, in respect of affected debt instruments, no trustee, no collateral agent, no indenture trustee, no fiscal agent, no bank that receives or holds funds from such eligible obligor related to the affected debt instruments, may exercise or continue to exercise any remedy under a contract or applicable law—

(1) for the non-payment of principal or interest;

(2) for the breach of any condition or covenant; or

(3) that is conditioned upon the financial condition of, or the commencement of a restructuring, insolvency, bankruptcy, or other proceedings (or a similar or analogous process) by, the eligible obligor concerned, including a default or an event of default thereunder.

(b) The term "remedy" as used in subsection (a) of this section shall be interpreted broadly, and shall include any right existing in law or contract, and any right to—

(1) setoff;

(2) apply or appropriate funds;

(3) seek the appointment of a custodian;

(4) seek to raise rates; and

(5) exercise control over property of the eligible obligor

(c) Notwithstanding any contractual provision or applicable law to the contrary, a contract to which the eligible obligor is a party may not be terminated or modified, and any right or obligation under such contract may not be terminated or modified, at any time during the suspension period solely because of a provision in such contract conditioned on—

(1) the insolvency or financial condition of the eligible obligor at any time before the commencement of the suspension period;

(2) the commencement of the suspension period or a restructuring process under chapter 2 of this Act; or

(3) a default under a separate contract that is due to, triggered by, or as the result of the occurrence of the events or matters in subsections (a)(1) or (a)(2) of this section.

(d) Notwithstanding any contractual provision to the contrary, a counterparty to a contract with the eligible obligor for the provision of goods or services shall, unless the eligible obligor

advises to the contrary in writing, continue to perform all obligations under, and comply with all terms of, such contract during the suspension period, provided that the eligible obligor is not in default under such contract other than—

(1) as a result of a condition specified in subsection (c) of this section; or

(2) with respect to an essential supplier contract, as a result of a failure to pay any amounts arising prior to the commencement of the suspension period.

(e) The suspension period shall terminate automatically without further action if—

(1) an approval order for such consensual debt relief transaction is denied, and is not remedied within sixty (60) days after such denial unless otherwise provided for in an order denying the application for an approval order; or

(2) no approval application has been filed with the Court within two hundred and seventy (270) days after the commencement of the suspension period, provided that the suspension period may be extended for one additional period of ninety (90) days if the eligible obligor and the holders of at least twenty (20) percent of the aggregate amount of the affected debt instruments in at least one class of affected debt instruments consent to such extension.

(f) The Court shall have the power to enforce the suspension period, and any entity found to violate this section shall be liable to the eligible obligor concerned for damages, costs, and attorneys' fees incurred by such eligible obligor in defending

against action taken in violation of this section, and punitive damages for intentional or knowing violations. Upon determining that there has been a violation of the suspension period, the Court may order additional appropriate remedies, including that the act comprising such violation be declared void or annulled.

Section 206.—Obtaining Credit.—

(a) After the commencement of the suspension period, an eligible obligor may obtain credit in the same manner and on the same terms as a petitioner pursuant to section 322 of this Act.

(b) Prior to or after the filing of an application for an approval order pursuant to section 204 of this Act, the eligible obligor may, to the extent required by any entity seeking to extend credit pursuant to subsection (a), seek from the Court, after notice and a hearing, an order approving and authorizing it to obtain such credit.

(c) Credit obtained pursuant subsection (a) of this section may not be treated as an affected debt instrument under chapter 2 or as affected debt under chapter 3 or avoided as a fraudulent transfer.

(d) If the eligible obligor subsequently seeks relief under chapter 3, the credit extended pursuant to this section shall be entitled to same priority and security as if such credit had been extended in a case under chapter 3.

(e) Section 322(e) shall apply to any order entered pursuant to subsection (b) of this section.

Section 207.—Adequate Protection for Use of Property Subject to Lien or Pledge.—

(a) To continue performing its public functions and to obtain an approval order or consummate a consensual debt relief transaction, the eligible obligor may use property, including cash collateral, subject to a lien, pledge, or other interest of or for the benefit of an entity, provided that the entity shall be entitled to a hearing, upon notice, to consider a request for adequate protection of its lien, pledge, or other interest as promptly as the Court's calendar permits, at which hearing the Court may condition the use of the collateral on such terms, if any, as it determines necessary to adequately protect such interest.

(b) Notwithstanding anything to the contrary in this Act, if revenues of an eligible obligor are subject to a pledge under which current expenses or operating expenses may be paid prior to the payment of principal, interest or other amounts owed to a creditor, the eligible obligor shall not be required to provide adequate protection pursuant to this section, to the extent that sufficient revenues are unavailable for payment of such principal, interest or other amounts after full payment of such current expenses or operating expenses.

(c) If the entity holding a lien, pledge, or interest in the collateral consents to its use, then the entity shall be deemed adequately protected on the terms, if any, in the consent and no further adequate protection shall be required.

Chapter 3: Debt Enforcement

Subchapter I: Petition and Schedules

Section 301.—The Petition.—

(a) A case is commenced under chapter 3 of this Act by the filing of a petition with the Court, either:

(1) by a petitioner upon the decision of its governing body and approval of GDB; or

(2) by GDB, upon the Governor's request, on behalf of a petitioner, if the petitioner's governing body has not authorized the petition and GDB determines that the petition is in the best interests of the petitioner and the Commonwealth.

(b) To enable GDB to coordinate the relief requested in all cases filed under chapter 3 of this Act, GDB shall be entitled to select and retain financial and legal professionals to prosecute each chapter 3 case on behalf of the petitioner and at the petitioner's expense, subject to sections 125 and 134 of this Act.

(c) A case may not be commenced under chapter 3 of this Act by any involuntary petition of creditors or other entities.

(d) The petition shall set forth:

(1) the amounts and types of claims against the petitioner that the petitioner, subject to amendment, contemplates being affected under the plan, sufficient to enable the Court to form a general committee pursuant to section 318(a) of this Act; provided that if the schedule in section 302(a)(2) of this Act is filed with the petition,

such schedule will satisfy the requirement in this subsection (1); and

(2) the assessment of the entity filing the petition pursuant to subsection (a)(1) or (a)(2) of this section that the petitioner meets the eligibility requirements provided in section 113(b) of this Act.

Section 302.—Petition Filing Requirements.—

(a) A petitioner shall file with the petition for relief under chapter 3 of this Act, or as soon as practicable thereafter, or if the petition is filed pursuant to section 301(a)(2) of this Act, no more than sixty (60) days after the date the petition is filed—

(1) a list of creditors the petitioner or GDB intends to be affected creditors and for whom the petitioner has readily accessible internal electronic records of names and mailing addresses or email addresses; and

(2) a schedule of all the claims against the petitioner, which existed on the date the petition was filed, intended to be affected under the plan, showing:

(A) the amounts outstanding as of the date the petition is filed;

(B) any seniorities or priorities among such claims;

(C) the collateral security, including pledges of revenues, for each claim;

(D) which of such claims the petitioner acknowledges as allowed and which claims

the petitioner disputes or contends are contingent or unliquidated; and

(E) the essential supplier contracts.

(b) A petitioner may amend its list of affected creditors and schedule of claims at any time (1) up to five (5) days before the deadline to object to a transfer of all or substantially all of the petitioner's assets or (2) before the voting record date established by the Court, and shall provide notice of such amendments to all creditors affected by such amendments.

Section 303.—Notice of Commencement.—

(a) Promptly after the fding of the petition and obtaining a date from the Court for the hearing specified in subsection (a)(2) of this section, a petitioner shall send to all the petitioner's affected creditors and contract counterparties for whom it has readily accessible internal electronic records of mailing addresses or email addresses and to all entities who file notices of appearance pursuant to section 119 of this Act notice of:

(1) the filing of the petition and the automatic stay;

(2) the date and time of the hearing on the eligibility of the petitioner for relief under chapter 3 of this Act pursuant to section 306 of this Act;

(3) the date that objections, if any, to the petitioner's eligibility must be filed;

(4) the schedule specified in section 302(a)(2) of this Act, or, if not available, the

schedule specified in section 301(d)(1) of this Act;

(5) the right of each affected creditor to advise the Court of its willingness to serve on the general committee to be appointed pursuant to section 318(a) of this Act, which advice shall be in the form of a notice filed with the Court prominently labeled as a "Notice of Willingness to Serve on General Committee," and shall clearly provide a disclosure of their economic interests as set forth in sections 318(d)(1) and 318(d)(2) of this Act; and

(6) the threshold for the special trade debt.

(b) A petitioner also shall provide supplemental notice of the information required by section 303(a) of this Act by publication as specified in section 116(c)(2) of this Act, and by posting on the website for its case under chapter 3 of this Act.

Subchapter II: Automatic Stay

Section 304.—The Automatic Stay.—

(a) Upon the filing of the petition, the following actions by all entities, regardless of where located, automatically shall be stayed with respect to affected debt:

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, arbitrative, administrative, or other action or proceeding against the petitioner or (insofar as relating to or arising from claims against the petitioner or the filing of the petition) against any enumerated entity that:

(A) was or could have been commenced before the filing of a petition under chapter 3 of this Act (including the request for a custodian); or

(B) is to recover on a claim against the petitioner or (insofar as relating to ox- arising from claims against the petitioner or the filing of the petition) against any enumerated entity, by mandamus or otherwise, which claim arose before the filing of a petition under chapter 3 of this Act;

(2) the enforcement against the petitioner or (insofar as relating to or arising from claims against the petitioner or the filing of the petition) against any enumerated entity of a judgment obtained before the filing of a petition under chapter 3 of this Act;

(3) any act to create, perfect, or enforce any lien against the petitioner's property;

(4) any act to collect, assess, or recover on a claim against the petitioner that arose before the filing of a petition under chapter 3 of this Act, including any act to obtain possession or control of property belonging to the petitioner; and

(5) the setoff of any debt owing to the petitioner that arose before the filing of a petition under chapter 3 of this Act against any claim against the petitioner.

(b) The stay in this section shall extend automatically to all affected debt added to the schedule described in section 302(a)(2) of this Act upon each amendment of such schedule.

(c) The petition shall not operate as a stay against the lawful exercise of police power by any Commonwealth Entity, the United States, or a state. Such exercise of police power shall not include the collection of interest or principal on any debt owed to the Commonwealth or GDB.

(d) The stay shall terminate with respect to property of the petitioner when the petitioner no longer has a legal or beneficial interest in the property.

(e) Unless terminated or modified by the Court pursuant to subsection (g) of this section, the stay of any act under this section shall continue until the earlier of:

(1) the effective date of the plan; or

(2) the time the case is dismissed and the dismissal is final and unappealable.

(f) Upon request of the petitioner, the Court may issue an order regarding the applicability and scope of the stay under subsection (a) of this section, and may issue an order enforcing the stay.

(g) The Court shall grant an entity relief from the stay, whether by terminating, annulling, modifying, or conditioning such stay, to the extent that—

(1) the entity's interest in property of the petitioner is not adequately protected against violations of the Commonwealth Constitution or the U.S. Constitution; or

(2) if-

(A) the petitioner does not have equity in such property; and

(B) no part of such property is used or intended to be used to perform public functions or otherwise foster jobs, commerce, or education.

(h) Upon objection to a motion seeking relief from the automatic stay, which objection shall be filed within fourteen (14) days of the filing of such motion, the Court shall commence a hearing no later than thirty (30) days after the motion for relief from the stay was filed unless a later date is otherwise agreed to by the petitioner and the affected creditor seeking relief from the stay. The affected creditor seeking relief from the stay shall have the burden to prove it lacks adequate protection, and the petitioner's lack of equity in the property. The petitioner has the burden to prove the facts relevant to relief pursuant to section 304(g)(2)(B) of this Act.

Section 305.—Remedies for Violating the Automatic Stay.—

Any entity found to violate section 304 of this Act shall be liable to the petitioner, and any other entity protected by the automatic stay, for compensatory damages, including any costs and expenses and attorneys' fees incurred by the petitioner in defending against action taken in violation of that section, and for punitive damages for intentional and knowing violations. Further, upon determining there has been a violation of the stay imposed by section [304] of this Act, the Court may order additional appropriate

remedies, including that the acts comprising such violation be declared void or annulled.

Subchapter III: Eligibility Hearing

Section 306.—Eligibility Hearing.—

(a) No later than thirty (30) days after the petition is filed, the Court shall hold a hearing, on notice in accordance with section 338 of this Act, to determine whether the petitioner is eligible for relief under chapter 3 of this Act.

(b) No later than forty-live (45) days after the petition is filed, the Court shall enter an order determining that the petitioner is or is not eligible for relief under chapter 3 of this Act upon a finding that the petitioner satisfies, or does not satisfy, as the case may be, the eligibility requirements in section 113(b) of this Act.

Subchapter IV: Enforcement of Claims by Foreclosure Transfer

Section 307.—Power to Transfer.—

(a) Subject to the remaining provisions of this section 307 and notwithstanding any contrary contractual provision rendered unenforceable by this Act, the petitioner, with the approval of GDB (or GDB at the request of the Governor on the petitioner's behalf), subject to Court approval after notice and a hearing, may transfer all or part of the petitioner's encumbered assets (which transfer may also include unencumbered assets) free and clear of any lien, claim, interest, and employee claims against a successor employer, for good and valuable consideration consisting of any and all of cash, securities, notes, revenue pledges, and partial interests in the transferred assets or enterprise.

(b) A petitioner shall not effect a transfer of assets to an entity that is not a Commonwealth Entity, including a transfer of all or substantially all of the assets of such petitioner, unless all the following requirements are met—

(1) applicable law (other than this Act) permits such transfer;

(2) the Court orders that the liens, claims, and interests shall attach to the proceeds of transfer in their order of priority, with each dispute over priorities to be resolved, in the Court's discretion, before or after the closing of the transfer; provided, however, that, in the event of a transfer of all or substantially all of the petitioner's assets, the petitioner may recover the reasonable and necessary administrative expenses incurred in its chapter 3 case in preserving or disposing of such assets that are transferred pursuant to this subsection;

(3) the Court shall have determined that the transferee shall have undertaken to perform the same public functions with the property acquired (either alone or together with other property and/or entity) as the petitioner had been performing, unless the Court determines that any public functions not to be performed by the transferee will be performed by another entity or no longer are necessary;

(4) the Court finds that a transfer to an entity that is not a Commonwealth Entity is the product of

(A) adequate marketing and arms-length bargaining designed to procure a price

that is at least the reasonably equivalent value of the assets proposed to be transferred, or

(B) a fair auction process;

(5) to the extent, if any, that the gross or net revenue of the petitioner to be transferred was pledged to secure any affected debt, such pledges shall have first priority against all portions of the proceeds of transfer other than portions allocable to other assets to be transferred free of liens or security interests securing allowed claims; and

(6) in the event of a transfer of all or substantially all of the petitioner's assets, all claims not scheduled pursuant to section 302(a)(2) of this Act shall be paid in full.

(c) For the avoidance of doubt, subsection (b) of this section does not confer any power on a petitioner to sell assets to a non-Commonwealth Entity that such petitioner does not currently posses under applicable law.

(d) A petitioner may effect a transfer of assets to a Commonwealth Entity, including a transfer of all or substantially all of the assets of such petitioner, notwithstanding any other applicable law to the contrary, only if—

(1) the Court orders that the liens, claims, and interests shall attach to the proceeds of transfer in their order of priority, with each dispute over priorities to be resolved, in the Court's discretion, before or after the closing of the transfer; provided, however, that, in the event of a transfer of all or substantially all of

the petitioner's assets, the petitioner may recover the reasonable and necessary administrative expenses incurred in its chapter 3 case in preserving or disposing of such assets that are transferred pursuant to this subsection;

(2) the Court shall have determined that the transferee shall have undertaken to perform the same public functions with the property acquired (either alone or together with other property and/or entity) as the petitioner had been performing, unless the Court determines that any public functions not to be performed by the transferee will be performed by another entity or no longer are necessary;

(3) the transfer to an entity that is a Commonwealth Entity is for a price that is at least the reasonably equivalent value of the assets proposed to be transferred, taking into account the requirement that they be used to perform the public functions the petitioner had been performing, unless the Court determines that any public functions not to be performed by the transferee will be performed by another entity or no longer are necessary;

(4) to the extent, if any, that the gross or net revenue of the petitioner to be transferred was pledged to secure any affected debt, such pledges shall have first priority against all portions of the proceeds of transfer other than portions allocable to other assets to be transferred free of liens or security interests securing allowed claims; and

(5) in the event of a transfer of all or substantially all of the petitioner's assets, all

claims not scheduled pursuant to section [302(a)(2)] of this Act shall be paid in full.

(e) The petitioner (or GDB at the Governor's request on the petitioner's behalf) may transfer part, but not all or substantially all, of the petitioner's assets not subject to a lien or pledge without Court approval if such transfer is independent of any and all transfers of encumbered assets.

(f) All transfers of unencumbered property or encumbered property or both shall be free and clear of successor liability imposed by otherwise applicable law.

(g) No transfer shall be approved unless the petitioner, or GDB on behalf of the petitioner, shall have included in its request for approval the reasons why such proposed transfer is reasonably likely to maximize value for creditors, in the aggregate, consistent with enabling the continued carrying out of the petitioner's public functions and the Court shall have found such reasons plausible.

Section 308.—Distribution of Proceeds of Transfer of Substantially All Assets.—

(a) In the event of a transfer of all or substantially all of the petitioner's assets pursuant to section 307 of this Act, after the closing of the transfer, the petitioner, with the approval of GDB (or GDB, at the Governor's request, on behalf of the petitioner), shall file a statement of allocation setting forth how the proceeds of transfer shall be allocated among each affected creditor or classes of affected creditors, and each affected creditor shall be entitled to object to the allocation by filing an

objection no later than thirty (30) days after the statement of allocation is filed. When the transfer proceeds include forms of consideration other than cash and cash equivalents, the statement of allocation shall provide which forms of consideration shall be distributed to which classes of claims, or whether the non-cash forms of consideration shall first be sold for cash and then distributed.

(b) The Court shall hold a hearing to determine each objection. When all objections are resolved, the petitioner shall file an amended statement of allocation of the proceeds of transfer consistent with the Court's rulings on the objections. Affected creditors shall have fourteen (14) days to file objections to the petitioner's amended statement of allocation—provided, however, that such objections, if any, will be limited only to arguments that the amended statement of allocation does not accurately reflect the Court determination— after which the Court shall hold a hearing to resolve the objections and shall issue a final statement of allocation binding on the petitioner and all creditors. If there is no objection timely filed to the petitioner's amended statement of allocation, the Court shall order that the net proceeds of transfer shall be allocated in accordance with the petitioner's amended statement of allocation without further notice or hearing.

(c) If substantially all of the petitioner's assets are transferred pursuant to section 307 of this Act, a plan distributing the value of the assets not subject to such transfer shall not be required, but may be filed at the discretion of the petitioner,

or by GDB on its behalf. If no such plan is filed, the final statement of allocation shall allocate the value of the assets that have not been transferred by means of such forms of consideration as are feasible and practicable under the circumstances.

Section 309.—Protection for Good Faith Acquirer.—

The reversal or modification on appeal of a transfer order shall not affect the validity of the transfer under such authorization to an entity that acquired such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such transfer were stayed pending appeal.

Subchapter V: Confirmation Requirements

Section 310.—Petitioner Exclusivity.—

A petitioner may file a proposed plan (and any amendment) or proposed transfer of all or substantially all the petitioner's assets if first approved by GDB, or GDB may file a proposed plan (and any amendment) or proposed transfer of all or substantially all the petitioner's assets on behalf of the petitioner with approval of the Governor. No other entity may file a proposed plan or file a proposed transfer of any of the petitioner's assets.

Section 311.—Plan Disclosure.—

The Court shall not confirm any plan unless the creditors' committee(s) and all affected creditors receive at least forty-five (45) days before the hearing on confirmation of the plan, a written disclosure statement, approved by the Court, containing:

(a) the material facts demonstrating the petitioner's reasons for contending the plan fairly uses the value of the petitioner's assets or operating revenues to maximize repayment of claims consistent with the performance of public functions or otherwise fostering a growing economy that will generate increasing revenues and enable greater claim repayment. Confidential or proprietary information may be redacted from any disclosure made;

(b) the treatment of each class of the petitioner's affected creditors under the plan and any material financial information reasonably necessary for such creditors to understand their future recoveries, if any, under the plan; and

(c) other information, if any, necessary to provide adequate information of a kind, and in sufficient detail, as far as reasonably practicable in light of the nature and history of the petitioner and the condition of the petitioner's books and records, that would enable a hypothetical creditor in the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan.

Section 312.—Affected Debt Entitled to Vote.—

Subject to the petitioner's right to deem a class to reject a plan, a class of claims of the petitioner is affected for purposes of voting under a plan unless, with respect to each claim of such class, the plan—

(a) leaves unaffected the legal, equitable, and contractual rights to which such claim entitles the holder of such claim;

(b) pays such claim in full in cash; or

(c) notwithstanding any contractual provision or applicable law that entitles the holder of such claim to demand or receive accelerated payment of such claim after the occurrence of a default—

(1) cures any such default that occurred before or after the filing of a petition under chapter 3 of this Act, other than a default of a kind that is not required to be cured or is unenforceable under this Act or a default creating no money damages;

(2) reinstates the maturity of such claim as such maturity existed before such default;

(3) compensates the holder of such claim for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;

(4) if such claim arises from any failure to perform a nonmonetary obligation, compensates the holder of such claim for any actual pecuniary loss incurred by such holder as a result of such failure; and

(5) does not otherwise affect the legal, equitable, or contractual rights to which such claim entitles the holder of such claim.

Section 313.—Plan Amendments.—

The petitioner or GDB may amend the plan at any time before confirmation, but may not amend the plan so that the plan as amended fails to meet the requirements of chapter 3 of this Act. After the petitioner files an amendment, the plan as amended

becomes the plan. Material modifications adverse to affected creditors shall require resolicitation and approval pursuant to section 315(e) of this Act prior to the confirmation hearing.

Section 314.—Confirmation Hearing.—

(a) After notice specified in section 338 of this Act, the Court shall hold a hearing on confirmation of the plan.

(b) Any creditors' committee may object to the treatment of its constituency's claims under the plan and any affected creditor may object to the treatment of its claims under the plan and each may be heard in opposition of or in support of the plan, by filing an objection or a pleading supporting the plan, in writing, no later than fourteen (14) days prior to commencement of the hearing on the plan.

Section 315.—Standards for Plan Confirmation.—

The Court shall confirm a plan only if all the following requirements are met:

(a) the plan substantially complies with all applicable provisions of chapter 3 of this Act;

(b) the plan separates affected debt into classes based on:

(1) differences in the claims' collateral security or priorities; or

(2) rational business justifications for classifying similar claims separately, provided that different maturities shall not render claims dissimilar;

(c) the plan provides the same treatment for each claim of a particular class, unless the holder of a particular claim agrees to a less favorable treatment of such claim;

(d) the plan provides for every affected creditor in each class of affected debt to receive payments and/or property having a present value of at least the amount the affected debt in the class would have received if all creditors holding claims against the petitioner had been allowed to enforce them on the date the petition was filed;

(e) at least one class of affected debt has voted to accept the plan by a majority of all votes cast in such class and two-thirds of the aggregate amount of affected debt in such class that is voted;

(f) the plan does not contain any provision causing a violation of an entity's rights under the Commonwealth Constitution or the U.S. Constitution that is not remedied or otherwise justified pursuant to section 128 of this Act;

(g) the petitioner shall be able to—

(1) make all mandatory payments provided by the plan and

(2) perform public functions;

(h) confirmation of the plan is not likely to be followed by the need for further financial reorganization of the petitioner, unless such reorganization is proposed by the plan, and all other provisions of the plan must be feasible;

(i) the plan has been proposed in good faith and not by any means forbidden by law, subject to section 108 of this Act;

(j) all administrative expenses accruing prior to the effective date of the plan shall be paid in full according to their terms or on the effective date of the plan, and all noncontingent, undisputed, and matured claims unaffected by the plan in accordance with section 327 of this Act shall be paid in full according to their terms; provided, however, that disputed or contingent claims shall be resolved in the ordinary course and paid as the parties agree or as the plan otherwise provides;

(k) each class of claims of affected debt that will not be satisfied in full under the plan absent the additional consideration provided in this subsection shall be entitled to receive annually in arrears its pro rata share of 50% of the petitioner's positive free cash flow, if any, at the end of any fiscal year, after payment of: (1) operating expenses; (2) capital expenditures (including capitalized expenses); (3) taxes, if any; (4) principal, interest, and other payments made in respect of financial indebtedness; (5) reserves; (6) changes in working capital; (7) cash payments of other liabilities; and (8) extraordinary items; in each case, incurred, expensed, and recorded in such fiscal year; such contingent payments to be made by the petitioner, but only to the extent necessary to pay each claim in full, including interest and any fees contractually required, for each of the first ten (10) full fiscal years ending after the first anniversary of the effective date of the plan, provided that once any claim is paid in full, its share of future contingent payments shall be ratably distributed to other affected creditors not yet paid in full;

(l) the effective date of the plan shall be the first date after confirmation of the plan that the confirmation order is not stayed and the petitioner or GDB files a notice with the Court that it is prepared to begin implementing the plan;

(m) with respect to affected secured claims (representing the amount by which a claim for principal, interest, and fees is secured by the value of the collateral security):

(1) both:

(A) the plan provides that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the petitioner or transferred to another entity, to the extent of the allowed amount of such claims; and

(B) each holder of such a claim receives on account of such claim immediate or deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the petitioner's interest in such property, with value being determined by the Court based on the plan's proposed disposition or use of the property, including its expected net revenues or net transfer proceeds if contemplated by the plan; or

(2) the plan provides for the transfer of any property that is subject to the liens securing such claims, free and clear of liens, and such liens attach to the net proceeds of such transfer;

(n) with respect to unsecured claims for affected debt (including deficiency claims, subject to section 331(d) of this Act, for secured affected debt that are based on a deficiency arising from liens against property having a value of less than the full amounts of the affected debt held by the affected creditor owning such liens), the plan shall be in the best interests of such creditors and shall maximize the amounts distributable to such creditors to the extent practicable, subject to the petitioner's obligations to fulfill its public functions;

(o) the petitioner shall have proved to the Court that it undertook—before or after the petition was filed—a reasonable program of cost reductions and income enhancements to try to maximize its repayment of affected debt under the plan, subject to the constraints that the petitioner must fulfill its public functions, and that some cost reductions or revenue enhancements may be counterproductive if they cause individuals or businesses to leave the Commonwealth, to reduce spending in the Commonwealth, or to reduce the consumption of services provided by the petitioner; and

(p) except to the extent agreed to by an affected creditor, the plan does not provide for a materially different and adverse treatment for such claim as compared to the treatment of claims in different classes under the plan having the same priority, unless the petitioner demonstrates a rational basis to permit such disparate treatment.

Section 316.—Compliance with Final Statement of Allocation and Confirmation Order.—

Notwithstanding any otherwise applicable law, the petitioner and any entity organized or to be organized for the purpose of carrying out a final statement of allocation issued pursuant to section 308 of this Act or a plan shall carry out the final statement of allocation or the plan and shall comply with all orders of the Court.

Subchapter VI: Case Management

Section 317.—Power of the Court.—

The Court, on its own motion or on the request of a party in interest—

(a) shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case;

(b) unless inconsistent with another provision of chapter 3 of this Act, may issue an order, notwithstanding the rules of civil procedure, prescribing such limitations and conditions as the Court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that—

(1) sets the date by which the petitioner shall file a disclosure statement and plan or a proposed transfer of all or substantially all the petitioner's property; or

(2) sets deadlines for pleadings, responses, replies, and other matters;

(3) may issue an order fixing the timing, scope, and format of any notice required under this Act.

Subchapter VII: Creditors' Committees

Section 318.—Formation of Creditors' Committees.—

(a) As soon as practicable after the petition is filed, but not later than fourteen (14) days prior to the first scheduled date of the eligibility hearing pursuant to section 306 of this Act, the Court shall appoint a general committee comprised of entities, based on the received Notices of Willingness to

Serve on General Committee, holding the largest amount of secured claims and largest amount of unsecured claims identified in the schedule of affected debt filed pursuant to section 301(d)(1) or 302(a)(2) of this Act. The general committee shall be comprised of at least five (5) and no more than thirteen (13) members, and, to the extent reasonably practicable, shall be representative of the categories of claims to be affected by the plan.

(b) The Court may appoint as the general committee a committee of creditors formed to negotiate with the petitioner prior to the filing of the petition; provided that the members of the prepetition committee are representative of the categories of claims to be affected by the plan.

(c) At the petitioner's or GDB's request, the Court shall appoint one or more additional committees, comprised of holders of affected debt held by particular creditor constituencies and identified by the petitioner in a written certification that the petitioner or GDB believes formation of such committee(s) would facilitate efforts to obtain a transfer pursuant to section 307 of this Act or confirmation of a plan. Such additional committee shall be comprised of at least three (3) and no more than seven (7) members. If and when an additional committee is disbanded or the petitioner or GDB certifies in a writing filed with the Court that it no longer believes an additional committee previously appointed will further facilitate a transfer pursuant to section 307 of this Act or confirmation of a plan or that the additional committee's costs outweigh its benefits, the additional committee no longer shall be eligible for reimbursement of its member

expenses and its professionals' fees and disbursements.

(d) Each creditors' committee member shall file with the Court, within twenty-one (21) days after its appointment to a creditors' committee, a verified statement declaring, as of the date of its appointment to the creditors' committee, that:

(1) the creditors' committee member, the entity to be acting on its behalf on the creditors' committee, and any affiliate of the foregoing that employed or is employed by such member, held or controlled, to the extent set forth in such statement, a beneficial interest in:

(A) any affected debt, specifying the face amount of each security or other claim;

(B) any interest, pledge, lien, option, participation, derivative instrument, or any other right or derivative right granting any of the foregoing an economic interest that is affected by the value, acquisition, or disposition of the affected debt, specifying each type of right;

(C) each other economic interest relating to any Commonwealth Entity, specifying each interest; and

(D) any credit default swap of any insurance company that insures any obligation of any Commonwealth Entity, specifying each type of interest; and

(2) no interest that the creditors' committee member, such entity to be acting on its behalf, or any such affiliate holds or controls and that should have been set forth pursuant to sections

318(d)(1)(A) through 318(d)(1)(D) of this Act may increase in value if any debt issued by any Commonwealth Entity declines in value.

(e) The holding or controlling at any time of any interest that should be set forth pursuant to section 318(d)(2) of this Act by the creditors' committee member, such entity that acts on its behalf, or any such affiliate shall disqualify such creditor from serving as a member of any creditors' committee. For the avoidance of doubt, the acquisition of such an interest by a creditors' committee member, such entity acting on its behalf, or any such affiliate, automatically shall divest the creditor of committee membership.

(f) Each creditors' committee member shall update its disclosure contemplated by subsection (d) of this section in writing filed with the Court within three (3) business days of each change in its previously disclosed holdings.

(g) Requests by the petitioner, GDB, or any affected creditor for changes or additions to creditors' committee membership shall be granted or denied in the Court's discretion. The Court's determinations of creditors' committee(s) membership shall not be appealable.

(h) Creditors' committee(s) members shall not be entitled to compensation for their time and service as creditors' committee members or to reimbursement of their expenses for retaining professionals to represent them individually, but the creditors' committee(s) shall be entitled from the petitioner to payment of fees to the extent permitted in section 333 of this Act, and creditors' committee(s) members shall be entitled to

reimbursement of their actual, reasonable, and documented out-of-pocket expenses for travel and lodging arising from their function as creditors' committee members.

Section 319.—Powers and Duties of Appointed Committees.—

(a) At a scheduled meeting of a creditors' committee, at which a majority of the members of such creditors' committee is present in person or by phone, the creditors' committee may select and authorize the employment of up to two (2) law firms, one of which must be resident in the Commonwealth, and one financial advisor, to perform services for such creditors' committee to be paid as administrative expenses in accordance with section 333 of this Act; provided, however, upon seven (7) days' notice to the petitioner and subject to the petitioner's right to object, the general committee may retain one or more additional professionals, including law firms, when and if reasonably necessary to represent different constituencies of the general committee in respect of material issues. If the petitioner objects to the general committee's proposed retention of any additional professional, the petitioner shall not be obligated to compensate such professional unless the Court rules its retention should be permitted.

(b) A creditors' committee may only:

(1) appear and be heard on any issue—

(A) relating to the eligibility hearing pursuant to section 306 of this Act;

(B) relating to adequate protection;

(C) involving new borrowing by the petitioner;

(D) concerning a transfer pursuant to section 307 of this Act or the allocation of proceeds of transfer pursuant to section 308 of this Act; and

(E) in connection with the plan, but solely as to matters regarding how the plan affects the creditors' committee's constituents;

(2) conduct a reasonable investigation into the petitioner's legal and financial ability to increase distributions under the plan for the creditors' committee's constituents; and

(3) negotiate with the petitioner over the treatment of its constituents in the plan.

(c) A creditors' committee appointed pursuant to section 318 of this Act or its authorized agent shall receive copies of notices concerning motions and actions taken by the petitioner (and any objections thereto) pursuant to sections 307 and 308 of this Act, and sections 310 through 316 of this Act.

(d) A creditors' committee may request discovery in accordance with the Puerto Rico Rules of Civil Procedure, but only with respect to the matters enumerated in subsections (b)(1)(A) through (b)(1)(E) of this section.

(e) Subject to redaction of confidential or proprietary information, affected creditors who are not committee members may obtain the same discovery produced to the creditors' committee and may obtain other discovery only, in each case, upon order of the Court for good cause shown.

(f) The committee shall not be a juridical entity capable of suing and being sued.

Section 320.—Limitations on Committees.—

(a) A creditors' committee appointed under chapter 3 of this Act shall not have standing to commence an action either directly on its own behalf or derivatively on behalf of the petitioner or on behalf of the petitioner's creditors, and may not be heard on any matter except as expressly provided in this Act.

(b) Each creditors' committee may make recommendations to its constituents with respect to the plan but cannot bind its constituencies or any member thereof to accept, reject, support, or object to any plan, and may not consent to a plan on behalf of any creditor.

(c) No member of a creditors' committee appointed pursuant to section 318 of this Act shall trade in claims against or securities issued by any Commonwealth Entity, unless the member:

(1) has established and enforces sufficient compliance procedures to prevent such member's representative on the creditors' committee from sharing information obtained as the member's representative with any entity within or retained by the member in connection with the trading of claims against or securities issued by any Commonwealth Entity;

(2) filed with the Court a notice of its intention to trade, which notice sets forth the details of the member's compliance procedures referenced in subsection (c)(1) of this section;

(3) obtained approval of its compliance procedures from the petitioner , which approval, in the petitioner's discretion, may be based on the recommendation of an entity knowledgeable in the securities industry and retained by or for the petitioner; and

(4) does not share information obtained from its service on the creditors' committee with any entity within or retained by the member in connection with the trading of claims against or securities issued by any Commonwealth Entity.

Section 321.—Disbanding Committees.—

All creditors' committees automatically shall be disbanded on the earlier of the date the Court issues the final statement of allocation pursuant to section 308 of this Act or confirms a plan for the petitioner, unless the final statement of allocation or plan provides otherwise or the Court orders otherwise. The petitioner may disband any additional committee appointed pursuant to section 318(c) of this Act by seven (7) days' written notice to such additional committee and the Court.

Subchapter VIII: Assets, Liabilities, Contracts, and Powers of the Petitioner

Section 322.—Obtaining Credit.—

(a) A petitioner may obtain unsecured credit and incur unsecured debt allowable under chapter 3 of this Act as an administrative expense.

(b) If the petitioner is unable to obtain unsecured credit allowable as an administrative expense, the Court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt—

(1) with priority over any or all administrative expenses of the kind specified in section 333 of this Act;

(2) secured by a lien on property of the petitioner that is not otherwise subject to a lien;

(3) secured by a junior lien on property of the petitioner that is subject to a lien; or

(4) any combination of the preceding clauses (1), (2), and (3), in addition to allowance as an administrative expense.

(c) The Court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on the petitioner's property that is subject to a lien only if—

(1) the petitioner is unable to obtain such credit otherwise; and

(2) either

(A) the proceeds are needed to perform public functions and satisfy the requirements of section 128 of this Act; or

(B) there is adequate protection of the interest of the holder of the lien on the property of the petitioner on which such senior or equal lien is proposed to be granted.

(d) In any hearing pursuant to this section, the petitioner has the burden of proof.

(e) The reversal or modification on appeal of an authorization pursuant to this section to obtain credit or incur debt, or of a grant pursuant to this section of a priority or a lien, shall not affect the

validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, was stayed pending appeal.

Section 323.—Use or Lease of Property not Subject to Court Approval.—

Unless the Court orders otherwise, without notice or a hearing, the petitioner may, in its sole discretion:

(a) pay on a current basis—

(1) its expenses accruing postpetition (exclusive of amounts related to prepetition indebtedness except as set forth in subsection (a)(2) of this section) and the costs and expenses incurred in connection with the case (including the reasonable fees and expenses of the professionals retained by or for the petitioner or GDB and any creditors' committee(s) formed under chapter 3 of this Act, subject to sections 318, 319 and 333 of this Act); and

(2) its prepetition debt not scheduled to be affected under the plan or that is necessary to pay to safeguard the petitioner's ability to perform its public functions;

(b) enter into transactions, including the lease of property, and use its property in its operations, including the use of revenues; and

(c) use cash and other resources as necessary to perform public functions, subject to section 324(a) of this Act.

Section 324.—Adequate Protection for Use of Property Subject to Lien or Pledge.—

(a) To continue performing its public functions and to obtain confirmation of a plan or approval of a statement of allocation, the petitioner may use property, including cash collateral, subject to a lien, pledge, or other interest of or for the benefit of an entity, provided that the entity shall be entitled to a hearing, upon notice, to consider a request for adequate protection of its lien, pledge, or other interest as promptly as the Court's calendar permits, at which hearing the Court may condition the use of the collateral on such terms, if any, as it determines necessary to adequately protect such interest.

(b) Notwithstanding anything to the contrary in this Act, if revenues of a petitioner are subject to a pledge under which current expenses or operating expenses may be paid prior to the payment of principal, interest or other amounts owed to a creditor, the petitioner shall not be required to provide adequate protection to such creditor pursuant to this section, to the extent that sufficient revenues are unavailable for payment of such principal, interest or other amounts after full payment of such current expenses or operating expenses.

(c) If the entity holding a lien, pledge, or interest in the collateral consents to its use, then the entity shall be deemed adequately protected on the terms, if any, in the consent and no further adequate protection shall be required.

Section 325.—Unenforceable Ipso Facto Clauses; Assignment of Contracts.—

(a) Notwithstanding any contractual provision or applicable law to the contrary, a contract of a petitioner may not be terminated or modified, and any right or obligation under such contract may not be terminated or modified, at any time after the filing of a petition under chapter 3 of this Act solely because of a provision in such contract conditioned on—

(1) the insolvency or financial condition of the petitioner at any time before the closing of the case;

(2) the filing of a petition pursuant to section 301 of this Act and all other relief requested under this Act; or

(3) a default under a separate contract that is due to, triggered by, or as the result of the occurrence of the events or matters in subsections (a)(1) or (a)(2) of this section.

(b) Notwithstanding any contractual provision to the contrary, a counterparty to a contract with the petitioner for the provision of goods or services shall, unless the petitioner advises to the contrary in writing, continue to perform all obligations under, and comply with all terms of, such contract, provided that the petitioner is not in default under such contract other than—

(1) as a result of a condition specified in subsection (a) of this section; or

(2) with respect to an essential supplier contract, as a result of a failure to pay any

amounts arising prior to the date when the petition is filed.

(c) All claims against the petitioner arising from performance by a contract counterparty pursuant to subsection (b) of this section, after the date when the petition is filed, shall have the status of an administrative expense. Failure by such contract counterparty to satisfy the requirement of subsection (b) of this section shall result in compensatory damages to the petitioner, in an amount determined by the Court.

(d) Notwithstanding any contractual provision to the contrary, except as set forth in subsection (e) of this section, on notice to the counterparty under the contract and upon Court approval, a petitioner can assign any contract, if the petitioner cures—or provides adequate assurance it promptly will cure—any default under such contract, other than a default that is a breach of an unenforceable provision under applicable law. Defaults on nonmonetary obligations that cannot reasonably be cured by nonmonetary actions may be cured as best as practicable with money damages.

(e) A petitioner shall not assign a contract of the petitioner, whether or not such contract prohibits or restricts assignment of rights or delegation of duties, if—

(1) applicable law excuses a party, other than the petitioner, to such contract from accepting performance from or rendering performance to the petitioner or to an assignee of such contract, and such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the petitioner, or to issue a security or other instrument of the petitioner.

(f) Only a party to a contract that a petitioner seeks to assign and having the right under such contract to enforce such contract, or such party's authorized representative, shall have standing to object to and be heard on the petitioner's requests pursuant to this section.

Section 326.—Contract Rejection, Impairment, and Modification.—

(a) Subject to subsection (d) of this section and Court approval, after notice and a hearing, and notwithstanding any contractual provision to the contrary, a petitioner may reject any contract if the rejection is in the petitioner's best interests; provided, however, that a petitioner may not reject a contract (except for collective bargaining agreements and retirement or post-employment benefit plans) where rejection of such contract would produce damages that would not exceed the threshold for special trade debt, as defined in section 102(52) of this Act.

(b) Any counterparty to a contract the petitioner seeks to reject shall file with the Court its calculation of rejection damages at least five (5) days prior to the hearing on rejection. A counterparty opposing rejection shall file such calculation with its objection at least seven (7) days prior to the hearing on rejection. The petitioner may object to such proposed damages at any time before confirmation.

Disputes concerning rejection damages shall be resolved by the Court.

(c) Rejection of a contract pursuant to subsection (a) of this section shall be treated as a material breach of such contract.

(d) The Court shall not approve the rejection of a collective bargaining agreement or retirement or post-employment benefit plan unless the petitioner has demonstrated that:

(1) the equities balance in favor of the rejection of such agreement or plan. In making such determination, the Court shall take into consideration the impact of the provisions of Law 66-2014, including any agreements made by employees and the petitioner pursuant to negotiations provided thereunder, on such agreement or plan;

(2) absent rejection, the petitioner will likely become unable to perform public functions; and

(3) the petitioner shared with the representative(s) for employees and retirees, as applicable, the data underlying its request to reject the agreement or plan and conferred, at reasonable times, in good faith with the representative(s) to reach voluntary modifications to such agreements or plans, and such efforts did not succeed;

(e) During a period when a collective bargaining agreement continues in effect, if essential to the continuation of the petitioner's public functions, or in order to avoid irreparable damage to the petitioner, the Court, after notice

and a hearing, may authorize the petitioner to implement interim changes in the terms, conditions, wages, benefits, or work rules provided by such collective bargaining agreement. Any hearing pursuant to this subsection shall be scheduled in accordance with the needs of the petitioner. The implementation of such interim changes shall not render the application for rejection moot.

(f) Nothing in this Act impairs the right, if any, of the petitioner under a collective bargaining agreement, retirement or post-employment benefit plan, or applicable law to terminate, modify, amend, or otherwise enforce any of the provisions of such collective bargaining agreement or retirement or post-employment benefit plan without obtaining the relief in subsection (d) of this section.

(g) Only a party to a contract a petitioner seeks to reject hereunder and having the right under such contract to enforce such contract, or such entity's authorized representative, shall have standing to object to and be heard on the petitioner's request pursuant to this section.

(h) Subject to subsection (b) of this section and section 327 of this Act, any damages arising from the rejection of a prepetition contract shall be treated as prepetition claims for affected debt that are neither priority claims nor administrative claims.

Section 327.—Unaffected Debt.—

The following expenses and claims arising prior to filing of a petition under chapter 3 of this Act shall not constitute affected debt under the plan and shall be

paid to the maximum extent practicable, without acceleration or other remedy arising from a default occurring prior to the effective date of a chapter 3 plan, according to the terms of the contracts pursuant to which the unaffected debt was incurred, and subject to applicable law:

(a) allowed unsecured claims of individuals for wages, salaries, or commissions, vacation, severance, and sick leave pay, or other similar employee benefits, earned by an individual prior to the petition date in accordance with a petitioner's employment policies or by applicable law, except to the extent that such claims arise out of a transaction that is avoidable under applicable law, including section 131 of this Act;

(b) except as provided in subsection (c) of this section, claims for the provision of goods or services other than claims arising under a rejected contract or special trade debt, provided, however, that any and all claims for provision of goods or services may be affected debt if the treatment of such claims as unaffected debt is a direct cause of other debt being substantially or severely impaired for purposes of the Commonwealth Constitution or the U.S. Constitution and such substantial or severe impairment is not remedied or otherwise justified pursuant to section 128 of this Act;

(c) notwithstanding subsection (b) of this section, critical vendor debt as determined by the petitioner;

(d) notwithstanding subsection (a) of this section, claims arising under a collective bargaining agreement or retirement or post-employment benefit plan, unless and until the claims arising

under such collective bargaining agreement or retirement or post-employment benefit plan are scheduled as affected debt pursuant to section 302(a)(2) of this Act or such collective bargaining agreement or retirement or post-employment benefit plan is rejected;

(e) claims owed to another public corporation (but only to the extent such claims are for goods or services provided by such public corporation to the petitioner), or to the United States;

(f) claims of a Commonwealth Entity for money loaned, or other financial support, to the petitioner during the sixty (60) days before the filing of the petition under chapter 3 of this Act, or claims of GDB for reimbursement pursuant to section 134 of this Act; and

(g) any credit incurred or debt issued by a public sector obligor between the commencement of the suspension period and the filing of a petition under chapter 3 of this Act, but only if such petition under chapter 3 of this Act is filed no more than six (6) months after the suspension period shall have elapsed.

Section 328.—Goods and Services Delivered within Thirty Days before the Petition is Filed.—

All valid amounts payable for goods received by or services rendered to the petitioner within thirty (30) days before the filing of a petition under chapter 3 of this Act shall have the status of an administrative expense and shall be paid in full, and according to the terms of the contracts pursuant to which the goods were provided or services were rendered to the maximum extent practicable. To the extent there is

any dispute as to the validity of such amounts payable, it shall be resolved pursuant to section 331(a) of this Act.

Section 329.—Assets Backing Retirement or Post-Employment Benefit Plans.—

All assets backing any pension plan, any retirement or post-employment benefit plan, and any other similar funded retiree or employee benefit shall be inviolable and shall not be considered in the calculation of the petitioner's value to be distributed pursuant to a plan under chapter 3 of this Act or final allocation statement pursuant to section 308 of this Act.

Section 330.—Subordination.—

(a) A subordination agreement is enforceable in a case under chapter 3 of this Act to the same extent that such agreement is enforceable under other applicable law.

(b) For the purpose of distribution under chapter 3 of this Act, a claim arising from rescission of a purchase or sale of a security or note of the petitioner or of an affiliate of the petitioner, for damages arising from the purchase or sale of such a security or note, or for reimbursement or contribution allowed on account of such a claim, shall be subordinated to all claims senior to or equal to the claim represented by such security or note.

Section 331.—Allowed Claims.—

(a) No creditor (affected or unaffected) needs to file a proof of claim to be entitled to payments on its claims. To the extent there are disputes between the petitioner and creditors as to the amounts of their claims, such disputes shall be

resolved using the same procedures applicable if there were no case under chapter 3 of this Act; provided, however, that claim objections pursuant to sections 330, 332 and 333 of this Act and rejection damage claims shall be determined only by the Court, subject to its power to abstain when the determination is not required prior to deciding whether a plan should be confirmed.

(b) A claim shall be an allowed claim if valid under applicable law to the extent—

(1) it does not include unmatured interest as of the petition date, and

(2) is not disallowed under another provision of this Act.

(c) The assertion of a claim in a chapter 3 case shall not constitute a legal proceeding subject to the disclosure requirement for government vendors and contractors pursuant to any applicable law. The existence of a claim under chapter 3 of this Act shall not constitute the basis for disqualification from any procurement process or for not entering into a contract with the petitioner.

(d) Nothing in this Act shall grant recourse status to non-recourse claims.

Section 332.—Claims for Reimbursement, Contribution, Indemnification, and Subrogation.—

(a) Claims for reimbursement, contribution, or indemnification shall not be allowed to the extent their allowance causes a petitioner to have liability to pay the same underlying debt more than once. To the extent such claims relate to debts in existence prior to the filing of a petition under

chapter 3 of this Act, such claims shall not be deemed administrative claims.

(b) The Court shall subordinate to the claim of an affected creditor and for the benefit of such creditor an allowed subrogation claim of an entity that is liable with the petitioner on, or that has secured, such creditor's claim, until such creditor's claim is paid in full, either through payments under chapter 3 of this Act or otherwise.

Section 333.—Payment of Administrative Expenses Pending Plan Confirmation.—

(a) A petitioner timely shall pay in full and in cash all administrative expenses incurred in connection with its operations and its case, including wages, salaries, commissions for services, trade debt, and monthly requests for reasonable fees and reimbursement of expenses incurred by the professionals retained by the petitioner (or retained by GDB on behalf of the petitioner, as provided by section 301(b) of this Act) and the creditors' committee(s), and the noticing agent.

(b) To the extent that a petitioner or GDB believes fees and expenses of a retained professional are unreasonable, it shall advise the applicant of its objection and the petitioner shall pay the undisputed portion. If the petitioner or GDB, as applicable, and the applicant are unable to reach an agreement about the disputed portion, either party may request the Court to rule on the reasonableness of such disputed fees and expenses. The petitioner or GDB, as applicable, may object to any applicant's fees as unreasonable for any legitimate reason.

(c) A petitioner or GDB may, in its sole discretion, retain an entity to serve as a fee examiner to review all fees and disbursements of all professionals for the petitioner and the creditors' committee(s). To the extent any professional requests payments in excess of those recommended by the fee examiner, the professional must procure a Court order allowing such additional amounts.

Section 334.—Custodian.—

(a) A custodian with knowledge of the filing of a petition under chapter 3 of this Act concerning the petitioner may not make any disbursement from, or take any action in the administration of, property of the petitioner, proceeds, product, offspring, rents, or profits of such property, or property of the petitioner, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.

(b) A custodian shall—

(1) deliver to the petitioner any property of the petitioner held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the filing of the petition; and

(2) file an accounting of any property of the petitioner, or proceeds, product, offspring, rents, or profits of such property that, at any time, came into the possession, custody, or control of such custodian.

(c) The Court, after notice and a hearing, shall—

(1) protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property;

(2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian; and

(3) surcharge such custodian for any improper or excessive disbursement, other than a disbursement that has been made in accordance with any applicable law, or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the filing of the petition.

Section 335.—Turnover.—

(a) Except for collateral secured and perfected by possession, and except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the petitioner may use or transfer pursuant to sections 307 and 323 of this Act, shall deliver to the petitioner, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the petitioner.

(b) Except as provided in this section, an entity that owes a debt to the petitioner that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the petitioner, except to the extent that such debt may be offset against a claim against the petitioner.

(c) Except as provided in section 304(a)(5) of this Act, an entity that has neither actual notice

nor actual knowledge of the filing of the petition concerning the petitioner, may transfer property of the petitioner, or pay a debt owing to the petitioner, to an entity other than the petitioner, with the same effect as to the entity making such transfer or payment as if the case under chapter 3 of this Act concerning the petitioner had not been commenced.

(d) Subject to any applicable privilege, after notice and a hearing, the Court may order an attorney, accountant, or other entity that holds recorded information, including books, documents, records, and papers, relating to the petitioner's property or financial affairs, to turn over or disclose such recorded information to the petitioner.

Section 336.—Surrender of Securities.—

If a plan requires presentment or surrender of a security or the performance of any other act as a condition to participation in distribution under the plan, such action shall be taken not later than five (5) years after the date of the entry of the confirmation order or as otherwise provided under the plan. Any entity that has not within such time presented or surrendered such entity's security or taken any such other action that the plan requires may not participate in any distribution under the plan.

Section 337.—Notice of Pleadings.—

(a) Service of any and all pleadings in a case under chapter 3 of this Act, arising in a case under chapter 3 of this Act, or related to a case under chapter 3 of this Act shall be sufficient if provided—

(1) by mail to the last known address or attorney of the affected creditor or other party in interest;

(2) by email to the email address provided by the affected creditor or other party in interest in any of such cases; or

(3) through The Depository Trust Company or similar depository.

(b) Service may be made within the Commonwealth and the United States and by first class mail postage prepaid or email as follows:

(1) notices required to be mailed to an affected creditor or indenture trustee (or entity performing comparable functions) shall be addressed as such entity or an authorized agent has directed in its last notice of appearance filed in the particular case;

(2) if an affected creditor or indenture trustee (or entity performing comparable functions) has not filed a notice of appearance designating a mailing address or email address, the notices shall be mailed to the entity's address, if any, shown on the list of affected creditors filed by the petitioner;

(3) if a list of affected creditors filed by the petitioner includes the name and address of a legal representative of a minor or incompetent person, and an entity other than that representative files a notice of appearance designating a name and mailing address that differs from the name and address of the representative included in the list of affected creditors, unless the Court orders otherwise, notices shall be mailed to the representative included in the list or schedules and to the name

and address designated in the notice of appearance;

(4) an entity and the noticing agent may agree that the noticing agent shall give the notice to the entity in the manner agreed to and at the address or addresses the entity supplies to the noticing agent. That address is conclusively presumed to be a proper address for the notice. The noticing agent's failure to use the supplied address does not invalidate any notice that is otherwise effective under applicable law;

(5) an affected creditor may treat a notice as not having been brought to the affected creditor's attention only if, prior to issuance of the notice, the affected creditor has filed a statement with the Court that designates the name and address of the entity or organizational subdivision of the affected creditor responsible for receiving notices under chapter 3 of this Act, and that describes the procedures established by the affected creditor to cause such notices to be delivered to the designated entity or subdivision and the notice does not conform to such designation; and

(6) if the papers in the case disclose a claim of the United States other than for taxes, copies of notices required to be mailed to all affected creditors under this Act shall be mailed to the United States Attorney for the District of Puerto Rico and to the department, agency, or instrumentality of the United States through which the petitioner became indebted.

(c) If, at the request of the petitioner, a party in interest with standing to be heard on a matter hereunder, or on its own initiative, the Court finds that a notice mailed within the time prescribed by these rules would not be sufficient to give an affected creditor with an address outside the Commonwealth and the United States to which notices under this Act are mailed reasonable notice under the circumstances, the Court may order that the notice be supplemented with notice by other means or that the time prescribed for the notice by mail be enlarged. Unless the Court for cause orders otherwise, the mailing address of an affected creditor with such foreign address shall be determined pursuant to subsections (b)(1) and (b)(2) of this section.

(d) The Court may, in its discretion, order specific noticing requirements for specific deadlines, hearings, and motions in the case, which orders shall supersede the noticing requirements in chapter 3 of this Act to the extent inconsistent.

Section 338.—Special Notices.—

(a) In addition to all other notices required hereunder, a petitioner shall provide special notices of (1) the filing of a petition, (2) the hearing on a petitioner's request for entry of an order determining the petitioner is eligible for relief under chapter 3 of this Act, (3) the hearing on a transfer pursuant to section 307 of this Act, and (4) the hearing on confirmation of the proposed plan. Such notice shall be posted on the website for its case under chapter 3 of this Act and published in accordance with section 116(c)(2) of this Act.

(b) Notice shall be transmitted to

(1) all parties in interest (except for holders of claims not scheduled pursuant to section 302(a)(2) of this Act) for whom a petitioner has readily accessible internal electronic records of mailing addresses or email addresses,

(2) all entities that file notices of appearance, and

(3) in accordance with subsection (c) below, holders of claims not scheduled pursuant to section 302(a)(2) of this Act.

(c) Notwithstanding any contractual provision or applicable law to the contrary, notice of the events set forth in subsection (a) of this section to holders of claims not scheduled pursuant to section 302(a)(2) of this Act shall be proper and reasonable if publication notice thereof is made in accordance with section 116(c)(2) of this Act.

Section 339.—Dismissal of Case.—

(a) After notice and a hearing, the Court may dismiss a case under chapter 3 of thla) a legislative determination that the state of fiscal emergency underlying the need for chapter 3 of this Act has ended; or

(1) a determination by the Court, or by a federal court whose judgment is final and unappealable, that the petitioner is eligible to prosecute a case under title 11 of the United States Code.

(b) The Court shall dismiss a case under chapter 3 of this Act, and may condition such dismissal on

such terms as are just, if the petition is withdrawn pursuant to section 112 of this Act.

Section 340.—Closing of Case.—

(a) After a plan is confirmed and effective, and all disputed claims are resolved, the Court shall close the case.

(b) A case may be reopened in the Court in which such case was closed to enforce the plan, to accord relief to the petitioner, or for other cause.

Section 341.—Escheat Rules.—

Any security, money, or other property remaining unclaimed at the expiration of the time allowed in a case under chapter 3 of this Act for the presentation of a security or the performance of any other act as a condition to participation in the distribution under any final statement of allocation or any plan confirmed under chapter 3 of this Act, or remaining unclaimed after the expiration of a time limit for claiming distribution under such final statement of allocation or such plan, as the case may be, becomes the property of the petitioner or of the entity acquiring the assets of the petitioner under the plan, as the case may be.

Chapter 4: Effectiveness of the Act

Section 401.—Effective Date.

This Act will be effective immediately upon its approval.

PERTINENT STATUTORY PROVISIONS

11 U.S.C. § 101. Definitions

* * *

(10) The term "creditor" means—

(A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;

(B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(g), 502(h) or 502(i) of this title; or

(C) entity that has a community claim.

* * *

(13) The term "debtor" means person or municipality concerning which a case under this title has been commenced.

* * *

(27) The term "governmental unit" means United States; State; Commonwealth; District; Territory; municipality; foreign state; department, agency, or instrumentality of the United States (but not a United States trustee while serving as a trustee in a case under this title), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state; or other foreign or domestic government.

* * *

(40) The term "municipality" means political subdivision or public agency or instrumentality of a State.

* * *

(41) The term "person" includes individual, partnership, and corporation, but does not include

governmental unit, except that a governmental unit that—

(A) acquires an asset from a person—

(i) as a result of the operation of a loan guarantee agreement; or

(ii) as receiver or liquidating agent of a person;

(B) is a guarantor of a pension benefit payable by or on behalf of the debtor or an affiliate of the debtor; or

(C) is the legal or beneficial owner of an asset of—

(i) an employee pension benefit plan that is a governmental plan, as defined in section 414(d) of the Internal Revenue Code of 1986; or

(ii) an eligible deferred compensation plan, as defined in section 457(b) of the Internal Revenue Code of 1986; shall be considered, for purposes of section 1102 of this title, to be a person with respect to such asset or such benefit.

* * *

(52) The term "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title.

* * *

11 U.S.C. § 109. Who may be a debtor

(a) Notwithstanding any other provision of this section, only a person that resides or has a domicile, a place of business, or property in the United States, or a municipality, may be a debtor under this title.

(b) A person may be a debtor under chapter 7 of this title only if such person is not—

(1) a railroad;

(2) a domestic insurance company, bank, savings bank, cooperative bank, savings and loan association, building and loan association, homestead association, a New Markets Venture Capital company as defined in section 351 of the Small Business Investment Act of 1958, a small business investment company licensed by the Small Business Administration under section 301 of the Small Business Investment Act of 1958, credit union, or industrial bank or similar institution which is an insured bank as defined in section 3(h) of the Federal Deposit Insurance Act, except that an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor if a petition is filed at the direction of the Board of Governors of the Federal Reserve System; or

(3)(A) a foreign insurance company, engaged in such business in the United States; or (B) a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in section 1(b) of the International Banking Act of 1978) in the United States.

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such

chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (C) is unable to negotiate with creditors because such negotiation is impracticable; or (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

(d) Only a railroad, a person that may be a debtor under chapter 7 of this title (except a stockbroker or a commodity broker), and an uninsured State member bank, or a corporation organized under section 25A of the Federal Reserve Act, which operates, or operates as, a multilateral clearing organization pursuant to section 409 of the Federal Deposit Insurance Corporation Improvement Act of 1991 may be a debtor under chapter 11 of this title.

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts

of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title.

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section other than paragraph (4) of this subsection, an individual may not be a debtor under this title unless such individual has, during the 180-day period ending on the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing

conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that—

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 7-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

(4) The requirements of paragraph (1) shall not apply with respect to a debtor whom the court determines, after notice and hearing, is unable to complete those requirements because of incapacity, disability, or active military duty in a military combat zone. For the purposes of this paragraph, incapacity means that the debtor is impaired by reason of mental illness or mental deficiency so that he is incapable of realizing and making rational decisions with respect to his financial

responsibilities; and "disability" means that the debtor is so physically impaired as to be unable, after reasonable effort, to participate in an in person, telephone, or Internet briefing required under paragraph (1).

* * *

11 U.S.C. § 903. Reservation of State power to control municipalities

This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—

(1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and

(2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.